The Economist

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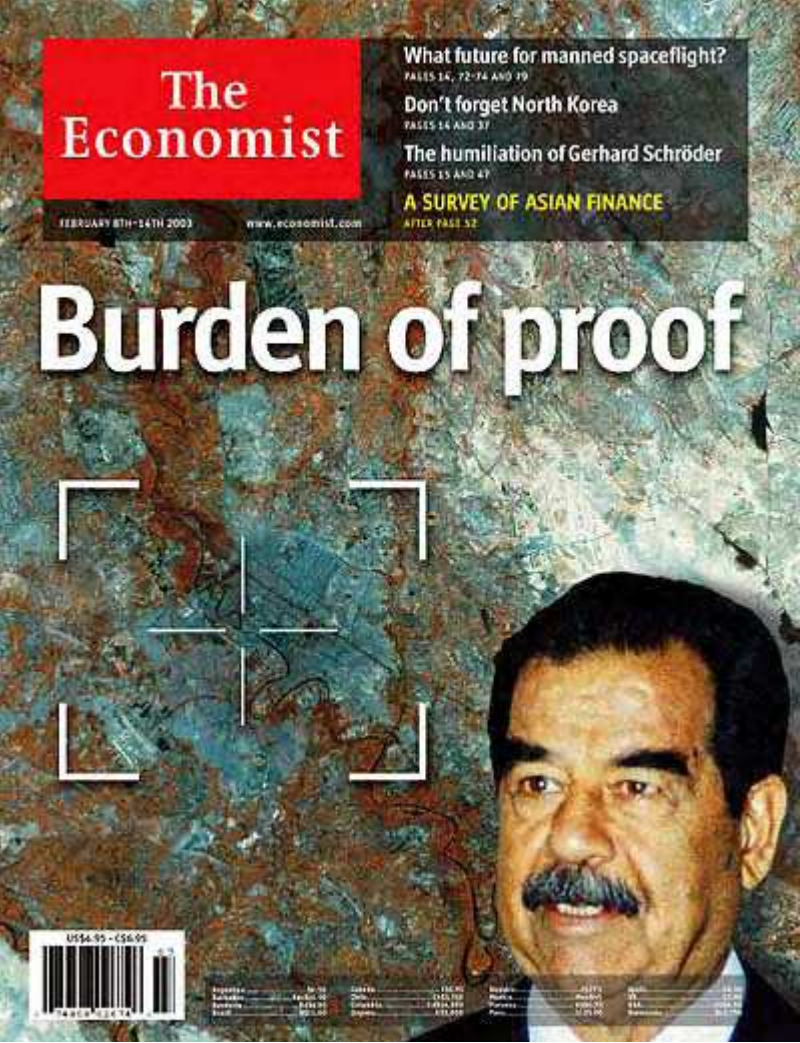

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Politics this week

Feb 6th 2003
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Powell the prosecutor

Reuters

America's secretary of state, Colin Powell, laid out evidence before the United Nations Security Council of **Iraq's** efforts to conceal weapons of mass destruction from the UN's weapons inspectors. After displaying telephone intercepts and satellite photographs of material being moved, Mr Powell told the council that “We must not shrink from whatever is ahead of us.” But France said the key was to strengthen arms inspections.

See article: Colin Powell makes the case against Iraq

Tony Blair, meeting Jacques Chirac on February 4th, failed to persuade him of the case for war against **Iraq**. Spain's Socialists refused to back the conservative government's support for an attack: “opportunists,” cried the government, which now lags in opinion polls.

See article: France and Britain agree to disagree

Turkey's voters, overwhelmingly opposed to war with Iraq, were told by their de facto leader, Recep Tayyip Erdogan, that if Turkey took no part it would have no voice in Iraq's future. It is under fierce American pressure to let bases there be used for an attack.

See article: Iraq's neighbours

Romano Prodi, chairman of the **European Commission**, gave warning to its 15 national leaders—five of whom recently issued a pro-Bush round robin—that if the EU did not speak with one voice no one would listen to it.

See article: Who speaks for Europe?

Fallen eagle

The **space shuttle** *Columbia* broke up on re-entry into the earth's atmosphere. All seven astronauts died. The cause of the accident is still unclear.

See article: After the shuttle

President George Bush presented a $2.2 trillion **budget** for fiscal 2004. It increased overall spending by 4% and estimated that the deficit in this fiscal year would stand at a record $307 billion. Defence spending was increased by $15.3 billion.

See article: Deficits as far as the eye can see

Latinos now account for most of the births in California—for the first time since the late 1850s.

Schröder under fire

Gerhard Schröder's Social Democrats were humiliated in state elections in Hesse and (already Social Democrat-held) Lower Saxony. **Germany's** conservative opposition thus consolidated its hold on the Bundesrat, parliament's upper house, which can block more than half of all legislation passed in the Bundestag, the lower house.

See article: Humiliation for Schröder

Yugoslavia's parliament approved a new constitution abolishing that name: read “Serbia and Montenegro”.

A shambles as **Britain's** House of Commons debated fresh reform of the House of Lords, which includes 92 hereditary peers and hundreds of life peers named by successive governments. Many ministers (and Labour's campaign pledges) back an elected chamber. The Commons could not agree on an answer.

See article: Reforming the House of Lords

After last month's **Dutch** election, the queen appointed two mediators to explore the prospects for a new coalition government linking the (just-) victorious Christian Democrats with the Labour Party.

A committee of the EU's constitutional convention began debating whether **God** should figure in its new charter, possibly as “the source of truth, justice, good and beauty”.

America on alert

American long-range bombers were on alert to move to Pacific bases if the “big problem” of **North Korea** turned into a crisis, Richard Armitage, the deputy secretary of state, told a Senate committee. He said America feared that the North would sell nuclear material to other states or terrorists to avoid economic collapse.

See article: Diplomacy, backed by force

South Korean tourist officials crossed into North Korea by road from Kosung when the two countries' land border was re-opened for the first time in half a century. Three other land links are planned. Tourists have previously visited the North by sea.

President Pervez Musharraf of **Pakistan** visited Russia's President Vladimir Putin in what a Russian commentator said was a move to “melt the ice” between the two countries. Russia is close to India, Pakistan's historic foe, and supplies it with 70% of its arms.

EPA

Striking off

In **Venezuela**, President Hugo Chávez claimed victory over his opponents when they called off a two-month general strike. Oil workers continued their strike, but oil production was recovering. The opposition claimed that more than 4m people voted in an informal ballot on different ways of ending the country's political conflict.

See article: After Venezuela's strike

Canada's prime minister, Jean Chrétien, and the leaders of provincial governments agreed to expand coverage of the country's publicly funded health service to cover the cost of some drugs and care at home. The federal government agreed to pay for a larger share of health spending.

See article: A row over upgrading Canada's health service

Last-minute party-switching came close to giving the government of President Luiz Inácio Lula da Silva a majority in the lower house of **Brazil's** new Congress.

See article: Brazil's new Congress

In its annual report to Congress on the **drug trade**, America's government chided Guatemala, Haiti and Myanmar—and expressed worries about exports of chemicals used for amphetamines and traffic in extra-potent marijuana from Canada. However, the administration said it would continue with aid to Guatemala and Haiti, on grounds of national interest.

No deal in Iran

Chris Patten, the EU's commissioner for external affairs, visited **Iran** to pursue a deal under which Iran would make various concessions in exchange for a trade and co-operation agreement. He found the reformist government too enfeebled to offer much.

See article: Iran, the EU and America

Saudi Arabia declared that it had decided to set a limit on foreign workers. Within the next ten years it intends to reduce numbers by more than half, bringing the proportion of foreigners down to 20% of the total population.

The treason trial of **Zimbabwe's** opposition leader, Morgan Tsvangirai, began in Harare. Prosecutors claim he and two others plotted to assassinate President Robert Mugabe. All three defendants pleaded not guilty.

Reuters

See article: Zimbabwe in the dock

France sent 450 troops to **Côte d'Ivoire** to reinforce the 2,500 already trying to uphold a recent peace deal to end a civil war. Pro-government crowds in Abidjan, the commercial capital, protested against what they saw as French bias in favour of the rebels.

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Business this week

Feb 6th 2003
From The Economist print edition

Heavy metal

The **dollar** was buffeted by worries over war in Iraq; it hit a four-year low against the euro of 1.09. The likelihood of war pushed **gold** prices to a seven-year high of nearly $390 an ounce. Other precious metals followed suit; platinum hit a 23-year high.

See article: Going platinum

The Bank of England surprised the markets with a quarter-point cut in **interest rates** to 3¾%; the first change since November 2001. The European Central Bank left rates unchanged.

See article: Interest rates

Underinsured

American International Group's shares fell by 7% after it announced charges of $1.8 billion in the fourth quarter, to cover a $2.8 billion provision for underwriting losses. The insurer blamed corporate claims for workers' compensation, health care and company directors' liability rather than asbestos claims, which have caused other big insurers to make similar provisions.

See article: AIG admits to big liabilities

Wheeler-dealing in the late 1990s caught up with **Frank Quattrone**, CSFB's notoriously bullish technology analyst. Mr Quattrone was suspended by the investment bank over “document retention issues” after he learnt of regulatory investigations into the “spinning” of hot technology offerings to favoured clients. Mr Quattrone denies any wrongdoing.

General Electric paid £848m ($1.4 billion) for First National, the consumer-finance arm of Abbey National. The British bank needs the cash to offset heavy losses in wholesale banking; GE Consumer Finance is keen to bolster its presence in Britain.

BNP Paribas, France's biggest bank, surprisingly ruled out a merger with Société Générale. The banks have flirted with a link for years and BNP failed in a hostile takeover in 1999. BNP also appears to have lost out to Crédit Agricole in the battle for Crédit Lyonnais, though it is still considering whether to raise its bid.

A poor fourth quarter pushed **Commerzbank** to a pre-tax loss for the year of *euro*372m ($350m), the German bank's first ever full-year loss.

For Canal, a reshuffle

Vivendi Universal's chief executive, Jean-René Fourtou, kicked off a restructuring of Canal Plus, the French media conglomerate's pay-TV arm, by sacking its boss of ten months, Xavier Couture. Mr Couture, appointed by Vivendi's former boss, Jean-Marie Messier, will be replaced by a trusted lieutenant of Mr Fourtou, Bertrand Meheut.

Vodafone began talks with Ripplewood, an American private-equity firm, over the sale of part of Japan Telecom. Vodafone, which completed the purchase of the fixed-line business along with J-Phone, a mobile operator, in 2001 had been expected to sell in order to concentrate on its mobile business.

Ericsson made a seventh consecutive quarterly loss in the final three months of 2002. The Swedish mobile-phone maker lost SKr8.3 billion ($913m) after a slump in demand for telecoms equipment. Ericsson also chose Carl-Henric Svanberg, currently boss of Assa Abloy, a lockmaker, as its new chief executive, sending its shares sharply higher.

Elan, Ireland's most valuable public company a year ago, announced a loss of $639m in the fourth quarter, taking losses for the year to $2.4 billion. The drug company is undergoing a big restructuring after its share price collapsed, the result of some questionable new products and dubious accounting practices.

Despite a big decline in tech spending, **Cisco Systems** made a record profit of $991m in the quarter to the end of January. The networking-equipment firm has benefited from falling component prices, coupled with aggressive cost-cutting. But Cisco gave warning that revenues would probably decline in the next quarter too.

Buzz off

Ryanair's acquisition of **Buzz**, a rival low-cost airline, for a bargain *euro*24m ($26m) from KLM Royal Dutch will come at the heavy cost of a big restructuring of the loss-making no-frills operation and an 18% cut in Buzz's workforce. The airline pilots' union threatened strikes; Ryanair countered with a threat to close Buzz, if necessary.

Two months after filing for Chapter 11 bankruptcy protection, **United Airlines** reported a loss of $1.5 billion for the fourth quarter of 2002. This shows the scale of the task facing the airline as it negotiates with unions and attempts to cut aircraft-leasing charges to return to solvency.

American Airlines called for annual wage cuts totalling $1.8 billion to curb losses of some $5m a day as the airline teeters on the brink of bankruptcy. It is also seeking savings of $2 billion a year through changes to its schedules and fleet.

See article: More problems for America's airlines

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America and Iraq

Burden of proof

Feb 6th 2003
From The Economist print edition

No “smoking gun” yet, but evidence of Iraqi guilt outweighs Iraq's pleas of innocence

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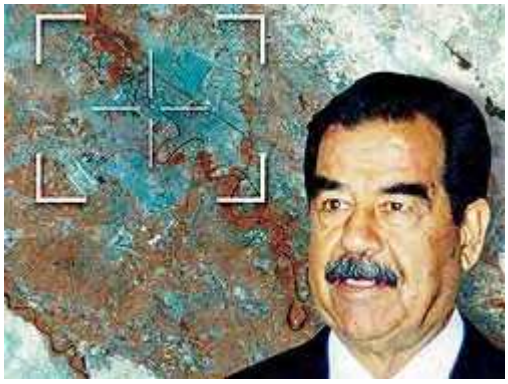

SO HOW was it for you? In an ideal world, working out whether Saddam Hussein still has or wants weapons of mass destruction (WMD) would not be a matter of subjective judgment, turning on how you rate Colin Powell's performance in the Security Council on February 5th. Some people feel that America's secretary of state put forward an impressive case. Others argue that most of what he said was familiar, and that the bits that were new were inconclusive (see article). The truth, vexingly, lies somewhere in between. But what is plain is that the Americans have not produced the fabled “smoking gun” that some governments insist on before they will support an American-led war to disarm Iraq.

Mr Powell's forceful rehearsal of the existing case against Mr Hussein will probably strengthen the conviction of those who say that Iraq's dictator poses a mortal danger to his region and the world, and so cannot be allowed to keep the deadly weapons America and Britain say he possesses. But the people and governments who never accepted this case in the first place will seize on the absence of any wholly clinching new evidence. Why has no western intelligence service published direct photographs of prohibited missiles or mass-killing weapons? How come America has not been able to guide the UN inspectors to any serious incriminating find on the ground? After a dozen years of Iraqi delinquency, shouldn't the spies of the CIA or Mossad have been able to wire the whole country up like an experimental rat? Why believe the defectors who tell America that they have seen mobile weapons labs that are invisible to western agents? And so forth. Although Mr Powell's evidence should not be set at nought—his satellite photos and intercepts suggest to any reasonable observer that Iraq has something to hide—America has failed to prove beyond doubt to a sceptical world that it has the weapons the Security Council has prohibited it from having.

Fools, knaves and sceptics

Does this failure demolish America's case for war? Hardly. A sceptic may be entitled to wonder why western intelligence has not yet produced stronger new evidence about the present location of Iraq's proscribed weapons. But it takes either a fool or a knave to swallow Mr Hussein's countervailing plea that he has none. Logic, and a veritable mountain of circumstantial evidence, point the other way.

If Mr Hussein has nothing to hide, why did he put up with economic sanctions, forfeiting billions instead of co-operating with the previous inspection regime in order to end them? Iraq's systematic deception of the first lot of inspectors sent to disarm it after the Gulf war is a matter of record, not conjecture. Iraq placed so many obstacles in front of these inspectors that they withdrew in 1998. Now the Iraqis maintain that, having pushed the inspectors out, they voluntarily destroyed all the chemical and biological munitions they had worked so hard to conceal—and kept no record of how and when they had done so. It is not only the Americans who consider this account incredible. It is only a week, remember, since Hans Blix, the chief inspector himself, told the Security Council that Iraq even now had not genuinely accepted the UN's 12-year-old instruction to disarm, reiterated unanimously last November in Resolution 1441. Without Iraq's active co-operation, he said, the inspectors could not verify that it had disarmed by playing “catch as catch can”. A country with Iraq's record deserves no presumption of innocence.

This week's drama in the Security Council does not mean that the search for evidence is over. A lucky break or a tip-off could still help the inspectors to catch the Iraqis red-handed. But with an army mustering on Iraq's borders, the Americans will not play this game for long. Mr Blix's next report to the Security Council is due on February 14th, and may be the last he is allowed to make before George Bush begins the countdown to war. Fighting might be postponed if Mr Hussein made a convincing last-minute decision to offer the inspectors the active co-operation he has so far withheld. Failing that, the only big question that remains is whether the war will be fought with the explicit authority of the Security Council, under a new resolution, or by a narrow coalition without one.

The exasperating French

A second resolution would be better. But this depends largely on France, which has so far used its influence to slow the move to war, and may yet use its veto to block such a resolution. That would not actually stop the war from happening: America and Britain claim, a bit too breezily, that they already have the authority they need. But the absence of a fresh mandate would deprive their action of useful international legitimacy, and reduce the support for it among their own citizens.

France has a habit of doing a lot of hemming and hawing before throwing in its lot with the Americans and British. That was its pattern before the last Gulf war. This time, however, the atmosphere is different. President Jacques Chirac says his aims are to uphold the authority of the Security Council and ensure that war is a last resort. But he does not need America's evidence to know about Iraq's cheating. He gives the impression of being more interested in clipping the wings of the superpower than in tackling the problem of Saddam.

Mr Chirac is not alone in thinking that America under Mr Bush and after September 11th is prone to taking unilateral action in the world. But in the case of Iraq Mr Bush has worked carefully through the Security Council. That decision produced Resolution 1441, warning Iraq of serious consequences if it failed to take this final opportunity to disarm. Mr Hussein has failed, and the Americans rightly insist that serious consequences must now ensue. If the French president thinks he is upholding the authority of the Security Council by allowing Iraq to treat such resolutions with scorn, he is wrong. And he is doubly wrong if he expects to constrain America by frustrating its efforts in the United Nations. Nothing could be better calculated to strengthen the spirit of American unilateralism he purports to detest. If France cannot in conscience support this war, better to stand aside than to stand in the way.

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The space shuttle

The Magnificent Seven

Feb 6th 2003
From The Economist print edition

First admire the astronauts and the American ideal they stood for; then reconsider the shuttle

Getty

Get article background

TRAGEDY has a strange effect on countries. In America, its main effect is to unify—to make the most diverse country in the world suddenly feel like a very small town. Twice now in barely two decades the space shuttle has prompted a period of national mourning—flowers, tears, prayers and much fighting talk from the country's politicians. “The American space programme must go on”, said George Bush. “Exploration is not an option we choose, it is a desire written in the human heart.”

The shuttle programme seems peculiarly and admirably American. There is the sheer technological achievement, of course. But, as with so many of America's strengths, it has more to do with a state of mind. The concept of the frontier, long dead in other countries, still matters in America—particularly its sunbelt states where NASA has its main bases. “It's all part of taking a chance and expanding man's horizons,” another adoptive westerner, Ronald Reagan, explained to the American people in 1986. “The future doesn't belong to the fainthearted. It belongs to the brave.” The crew, whose casual diversity also typified America (see article), knew exactly the risks that they were running.

Yet it does no disservice either to the memory of the dead astronauts or to the ambitions of those keen “to slip the surly bonds of earth” to re-examine the shuttle programme. The first set of questions revolves around this week's accident. The causes have not been established, but many Americans already find it odd that, once the shuttle had taken off, the astronauts had no means to mend any damage and no escape-route. The shuttle's technology is quite old. There are also accusations that the accident was linked to cutbacks at NASA. These seem implausible—the programme still chews up $7 billion a year—but they need to be rebutted.

The second, broader, set of questions concerns the shuttle's rationale. It was conceived as a frequent taxi service, making cheap ($5m) weekly flights into space and carrying huge cargoes. Now that the shuttle makes only five flights a year, each at a cost of $500m, NASA has justified the project in terms of benefits to science (see article). This does not stand up. Much of the science that the shuttle crew does could equally well be done by robots: for instance, one astronaut on the *Columbia* was, it transpires, an unneeded photographer for a dust experiment. More generally, the money spent on the shuttle might be more productively spent on unmanned probes or even on earthbound experiments. The questions that intrigue us all about space—Is there life on Mars? How do comets work?—will not be answered by manned spacecraft in the foreseeable future. And the argument has hardly been improved by the International Space Station, a permanently manned hotel parked just above earth that was invented largely to give the shuttle a purpose.

So science and economics demand a substantial rethink. That rethink probably means putting far more money into unmanned spacecraft. But it should not automatically mean that manned spaceflight be scrapped forthwith. For in the end, as Mr Reagan understood, the shuttle is about more than science, economics or perhaps even logic. Sending people into space—no less than climbing Everest—is about national greatness and human ambition. Rather than inventing false prosaic reasons for its mission, NASA might do better to name a boldly poetic target: putting a man on Mars, say. America will get there in the end. And all of us will be proud of it.

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North Korea

Taking a stand

Feb 6th 2003
From The Economist print edition

Diplomacy is fine if it works. But it might not

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EPA

COUNT on North Korea's Kim Jong Il to try to make the best, by making the worst, of a difficult moment. As President George Bush seeks to pile the pressure on Iraq to give up its weapons of mass destruction, or else, Mr Kim is once again raising the stakes in his row with America and his neighbours over his own illicit nuclear dabbling. Since October, when he was found out and then owned up to enriching uranium, Mr Kim has thrown out international inspectors watching over a stash of plutonium-laden spent fuel rods from an earlier nuclear programme and flounced out of the Nuclear Non-Proliferation Treaty. Now he is thought to be moving the rods in readiness to extract their weapons-usable booty, enough for five or six bombs. He has not, so far, started the extracting, nor carried out his threat to resume tests of far-flying missiles that could carry nuclear warheads. But take little comfort in that.

With the Iraq crisis for cover, Mr Kim may be gambling that he can get away with all this and worse. Although North Korea has so far only talked of burning up the neighbourhood in a “sea of fire” (whereas Saddam Hussein has twice invaded his neighbours and fired off missiles at Saudi Arabia and Israel), America's commander in the Pacific was this week mulling the need for more ships and aircraft, just in case.

How dangerous all this does become depends on what Mr Kim is really up to. And, in truth, no one knows. Some argue that he is genuinely, if thuggishly, searching for a way out of his bunker: looking to trade in his bomb-making for the non-aggression treaty and recognition he keeps demanding of America, and large dollops of aid from everyone else to rescue his clapped-out economy. Equally plausibly, however, he may be calculating that the worse his misbehaviour, the bigger the bribe he will be offered to stop it—and the better his chances of keeping his weapons into the bargain.

Such blackmail has worked before. In 1994, after North Korea had pushed an earlier nuclear crisis over its illicit plutonium production to the brink of war, South Korea, Japan and China all backed away and left America to scramble together a deal that stopped more plutonium being readied for bombs by offering the North two western-designed nuclear reactors (with a whopping $5 billion price tag) and interim deliveries of fuel oil. But without proper checks on his nuclear industry, it is now clear, Mr Kim cheated on regardless.

The Bush administration is right to insist that it will not be blackmailed again. Equally properly, it wants North Korea to be held to account for breaking international agreements, and is pressing for the International Atomic Energy Agency, whose inspectors Mr Kim ejected, to raise the issue at the UN Security Council. Though more wary of involving the UN for now, South Korea, Japan, China and Russia all recognise that an unpredictable North Korea left to brandish its weapons will threaten the stability of the entire region. They have offered to provide the multilateral cover America has asked for in order to get direct talks with North Korea going. But so far the North has given them the brush off. So what more can they do?

South Korea's new president, who takes office later this month, is still hoping, like his departing predecessor, to persuade Mr Kim of the enormous economic benefits to be had from an end to the nuclear stand-off. Japan stands ready to resume talks on aid. China and Russia are keen to help exploit

the trade opportunities if remaining sanctions on North Korea are lifted and its decaying infrastructure can be rebuilt.

America, too, says it is ready to offer North Korea “more for more”, meaning aid and a broad improvement in relations, in return for a deal that would—verifiably this time—put it out of the nuclear business and start to address other security issues, such as its destabilising missile sales and the tense stand-off at the border between North and South Korea. Isn't that merely succumbing to blackmail by another name? Perhaps not, if North Korea finally gives up its option, jealously guarded so far, of periodically holding the neighbourhood to ransom.

Even with the worst of intentions

But the diplomats are still a dauntingly long way from there. The Bush team is divided over what “more” it could offer. Secretive North Korea may anyway balk at the intrusive inspections needed to be sure it was keeping its word. Meanwhile it still insists publicly that it will talk only to America, and has spurned assurances that America has no intention to attack.

And if Mr Kim keeps on toughing it out and building his bombs? Then America, South Korea, Japan, China and Russia will need to get tougher too. Even a deal-seeking Mr Kim will keep ramping up the tension so long as he thinks he can drive a harder bargain. Only a concerted stand and the message that aid will not flow until the weapons go can hope to put a stop to that. And if Mr Kim is bent on keeping his bombs? Even more reason for America, its allies, China and Russia, to stand together. North Korea unrestrained is a threat to them all.

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Germany and its chancellor

Gerhard Schröder's last chance

Feb 6th 2003
From The Economist print edition

If he drastically changes his ways, Germany's battered chancellor can still rescue his country

Getty

Get article background

IT WAS a brutal but well-deserved rebuff for the pusillanimous and opportunistic populist who has been running Germany's federal government for the past four-and-a-half years. The scale of defeat for his Social Democrats in two of the country's chunkier states was greater than even the gloomiest of the chancellor's friends had expected. If a general election were held in Germany today, Gerhard Schröder's lot would plainly be thrashed. But he and his Social Democrats, in tandem with their Green allies, are unlikely to bow out any time soon, despite their slim majority in the Bundestag, Germany's lower house of parliament. Amid the debris of last weekend's defeat, the chancellor has a fleeting chance to make amends.

How come? The conservatives have consolidated their previously tenuous hold on the Bundesrat, parliament's upper house, where Germany's 16 states are represented and which can block more than half the legislation passed in the Bundestag, including all bills to do with finance and tax. So a de facto "grand coalition" may hopefully emerge, with both Mr Schröder and his conservative rivals already promising to co-operate for the good of the country. In the vital area of labour-market reform, where the chancellor has characteristically shilly-shallied since a raft of useful proposals was presented and at first endorsed by him last summer, he seems bent on pressing ahead again—with the conservatives giving him the necessary leeway (see article).

But even on this score there are snags. Well over half the Bundestag's Social Democrats are trade-union members or officials. Many are loth to back painfully radical reforms of the labour market, though its sclerosis is a big cause of the country's soaring unemployment, now, at 4.6m, amounting to 11% of the workforce. Whatever his recently professed good intentions, Mr Schröder has a woeful habit of tacking to and fro to keep his party faithful happy. There is still no guarantee that he will risk the wrath of the left.

In any event, the gap between even reform-minded Social Democrats and their conservative and liberal rivals in other fields of reform—pensions, health care, taxation and the welfare state in general—needs bridging. The Christian Democrats must, as they have promised, do their utmost to seek compromise. But they will rightly refuse to endorse new legislation that they deem to make no serious improvement. With his usual prevarication and denials, Mr Schröder, egged on by his left, has sought to plug his country's widening deficit by raising taxes or putting off tax reforms, a policy the opposition conservatives and liberals are bound to block.

Nor does it help that the German people themselves still sound ambiguous about reform—especially where it threatens to squeeze them personally. Despite the bleak figures for unemployment and economic growth (a pathetic 0.2% last year, with scant improvement expected this year), those in work remain reluctant to accept an erosion of their cosy job-protection laws and extravagantly comfy welfare state, which help sustain Germany's sky-high and increasingly uncompetitive labour costs. In this respect, Mr Schröder must discover his hitherto hidden backbone—unless he is to go down in history as Germany's worst chancellor since the second world war.

In foreign affairs, he may already be irredeemably doomed to bear that epithet. Not that his broad stance against war in Iraq has been inherently foolish or dishonourable; after all, most of his compatriots and perhaps most fellow Europeans still doubt whether the Americans have made their case for it,

especially if they seem bent on attacking Iraq even without UN approval. But it is Mr Schröder's crass insistence that Germany will oppose a war even if the rest of the UN's Security Council endorses it that threatens to leave his country utterly isolated and ridiculed in Europe, so ruining its effort since reunification to earn more influence on the global stage.

Go for the home run, at least

But it is at home that Mr Schröder now faces his biggest challenge. He is an able tactician and remarkably durable. He has proved before that he can clamber back out of a hole. He has shown guts on occasions. Some of his tax reforms in his first term in office were laudable. So was his courage in persuading the Bundestag to let German combat troops be sent to the Balkans and Afghanistan.

And yet, again and again, the chancellor has spoilt his reputation for the sake of cheap popularity, either at the polls or by pandering to his party's powerful, backward-looking, trade-union-connected rank-and-file. What this weekend's election setbacks show is that his fabled charm has finally worn off. Now he will be judged only by results. He still has three years to redeem himself. Even though his past record gives, at best, patchy cause for hope, he has a last chance of doing so.

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Venezuela's conflict

No end to the pain

Feb 6th 2003
From The Economist print edition

Hugo Chávez's hollow victory spells wider problems

AFP

ONLY a generation ago, Venezuela was as rich as Spain. The country was widely hailed as one of Latin America's more solid and egalitarian democracies. It is extremely hard to believe that now. Years of decline have culminated in an extraordinary spectacle of self-destruction.

For the past two months, President Hugo Chávez stood unyielding as a broad opposition coalition sustained a general strike aimed at ousting him. The oil industry, the source of 14% of the United States's oil imports, was all but paralysed, contributing to an increase of $5 in the world oil price. Venezuela's economy shrank by 8.5% last year, not much less than stricken Argentina's. This year, with political conflict set to continue for many months, independent economists forecast a further shrinkage in GDP of 10-20%.

This desolation puts the proud claim of “victory” which Mr Chávez made last weekend in proper perspective. He has successfully faced down the strikers; most have given up, and the diehards in Petróleos de Venezuela (PDVSA), the state oil company, look close to doing so. The president has survived. But Venezuela itself has paid a heavy price for his victory.

Naturally, this is not how Mr Chávez and his supporters see it. In their view, a president who was elected twice and survived a military coup last April is a tribune of the poor who has defeated a small group of fascists and oligarchs which sought to remove him by unconstitutional means.

The opposition certainly faces some hard questions. It underestimated Mr Chávez, who probably still enjoys the support of one Venezuelan in three. It seemed to hope that the strike would provoke the army to force the president to negotiate. The generals failed to oblige. And although the opposition organised a do-it-yourself referendum, in which it claims 4m people voted for Mr Chávez to leave office, its own leadership lacks credibility. Devoid of a coherent programme beyond anti-*Chavismo*, the opposition relies too much on the newspapers and TV stations it owns to take the place of political parties. Rather than dragging out the strike, it would have done better to work for the “recall referendum” on the presidency which the constitution allows from next August.

Mr Chávez, a former army officer and coup leader, has proved adept at turning the mistakes of his opponents to his own advantage. During four years in office, he has methodically added to his power. He brought in a new constitution which gave him control over the country's political institutions and enabled him to extend his term until 2006. Last April's failed coup gave him control over the armed forces. Now the failure of the strike will increase his power yet again. He is close to gaining control of PDVSA, not least by refusing to take back 5,000 sacked oil strikers (see article). The strike also prompted the government to impose foreign-exchange controls, thereby giving it new power over the private sector, including the media. And because the defection of judges had imperilled his hold over the supreme court, Mr Chávez now proposes to expand its size. That could make it easier for the president to obstruct a speedy, free and fair vote in the recall election, if one is allowed to take place.

Onward to a referendum

It is now essential that one should take place. The opposition may exaggerate when it says that Mr

Chávez wants to turn his country into another Cuba. He claims he is not against capitalism—just local capitalists. But he already acts like an elected version of that familiar Latin America figure, the military *caudillo* (see article). The future he offers Venezuela looks ominously like that of a backward satrapy of six-hour monologues from an all-powerful “revolutionary” windbag. For all the corruption and errors of the governments that preceded Mr Chávez, it is hard to imagine that this is the destiny of a large and fairly modern country. But oil, Mr Chávez's cunning, and his opponents' incompetence, are pushing that way.

All the evidence is that most Venezuelans want their country to remain a democracy, and that most believe that Mr Chávez is no longer governing as a democrat. If Venezuela fails to return to full democracy, the damage will spread beyond its own borders, sending a malign signal to the weaker democracies of Latin America. Brazil and Mexico, and even Colombia or Argentina, have distinctive political histories, and are probably immune to *Chavismo*. But the likes of Ecuador or Bolivia may not be. In setting up a six-country group to mediate in Venezuela's conflict, Brazil has recognised the problem. The mediators' aim should be to ensure a free and fair vote, preferably in August. Venezuelans deserve the chance to halt their own decline. Latin American strongmen and their ersatz “revolutions” have brought little but misery to countries that could otherwise prosper.

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About sponsorship

Rating agencies

Let go of nanny

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The case for taking credit ratings out of financial regulation

IT SOUNDS like a great new idea. Avoid heavy-handed central regulation. Instead, harness market forces, in the shape of private-sector credit-rating agencies. Protect investors and banks by using their ratings in your rules for capital adequacy and investment. Best of all, because companies themselves pay for the ratings, it can all be done at zero cost.

In fact, it is not a new idea at all. Ratings have been used by regulators since America's Investment Company Act of 1940, which laid down that money-market funds could invest only in high-quality assets, determined by what came to be known as investment-grade ratings. Over the past few decades, regulators have become ever more reliant on credit ratings; the Securities and Exchange Commission (SEC) has even established “nationally recognised statistical rating organisations”. Only three agencies qualify: Standard & Poor's, Moody's and Fitch. They have become big businesses, moving into ever more exotic financial instruments, offering to pre-rate securities planned by an issuer, and selling advisory services. Bank supervisors now plan to incorporate ratings into the revised Basel accords on bank capital standards.

What could be wrong with all this? Plenty, as it happens. A new report by the SEC, commissioned by last year's Sarbanes-Oxley act, has ventilated some of the possible drawbacks (see article). But it dithers over possible cures, and steers away altogether from by far the most sensible idea: to reverse the trend of the past 60 years, and start taking credit ratings out of financial regulation altogether.

It is not that the rating agencies do such a terrible job. Yes, their ratings of sovereign debt failed to warn of the East Asian crisis of 1997—but then, so did the International Monetary Fund. The agencies have also taken flak for not noticing that Enron and WorldCom were going bust—but then, neither did these firms' auditors. By comparison with credulous Wall Street analysts, who kept near-perpetual buy recommendations on shares right through the bursting of the stockmarket bubble, credit raters seem models of sober judgment.

And yet the rating agencies share some of the problems of the analysts. The most obvious is conflicts of interest. Not only are they beholden for their fees to companies whose securities they rate; they often sell the same clients a parcel of advisory services. Just as for audit firms, which did likewise until Sarbanes-Oxley stopped them, the temptation is to keep up ratings in return. Then there is the issue of competition. The SEC has bestowed recognised status on several newcomers in the past 30 years—but those have since merged into the original three. The agencies move in near-lockstep, in fees and in the ratings they give.

It gets worse. As ratings have been more widely used in regulation, they have begun to affect the market, in a version of Goodhart's law (that any variable chosen as a monetary-policy target immediately starts to behave differently). Because regulators and banks use ratings to assess credit risk, a rating downgrade can itself become a trigger requiring higher interest payments from a borrower or even driving it into bankruptcy. Similarly, rather as teachers often teach to the test, financial instruments are increasingly designed solely to carry a particular rating, not the other way round. The effect of both distortions is to discourage agencies from changing ratings on objective grounds until it is too late.

Imprisonment or freedom

There are, in principle, two different cures for these ills. One, which the SEC appears to favour, is to increase the supervision and regulation of the rating agencies. Stop them offering advisory services to clients, for instance; set new rules for the behaviour and pay of their staff; or impose competition by recognising more agencies.

The trouble is that such measures would increase, not reduce, the burden and cost of regulation. Hence the appeal of the second cure: take ratings out of regulation altogether, and return the agencies to their role as servants not masters of the capital markets. Capital-adequacy rules could be set using other risk measures, such as the spreads at which securities actually trade in the markets. Restrictions on investments should mostly be scrapped: it makes no sense to insist that funds buy only investment-grade bonds when they can buy any old equities, which are often riskier than even junk bonds.

The analogy with equities is worth pondering. Suppose regulators ruled that retail investors or mutual funds could buy shares only if a majority of investment-bank analysts had a buy recommendation on them. Would that protect investors, or improve the analysts? Hardly: yet it is, in essence, what happens for many debt securities. It is time for regulators and investors to let go of their rating-agency nannies.

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Letters

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From Economist.com

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

The Columbia disaster

SIR - *The Economist* suggests that “lavishing” billions on human space flight may not be money well spent (”The lessons of Columbia”, Global Agenda, Economist.com, February 3rd). A ten-year programme to land people on Mars is estimated to cost $50 billion. President Bush is estimated to be planning on spending £100 billion-200 billion on a war with Iraq this year. This doesn't include what has already been spent on Afghanistan and elsewhere.

I know which of these I consider to be better value for money in both the short and long term...and I'd rather be on Mars, thanks.

Steve Withers
Kapiti, New Zealand

SIR - After reading your article (“The lessons of Columbia”), I turned to Richard P. Feynman's “Personal Observations on the Reliability of the Shuttle”, made as part of the official report into the 1986 Challenger accident. Mr Feynman started by saying: “It appears that there are enormous differences of opinion as to the probability of a failure with loss of vehicle and of human life. The estimates range from roughly 1 in 100 to 1 in 100,000. The higher figures come from the working engineers, and the very low figures from management. What are the causes and consequences of this lack of agreement?”

Today, is there any lack of agreement? The final line of Mr Feynman's observations reads: “For a successful technology, reality must take precedence over public relations, for nature cannot be fooled.”

James Barton
London

Policing child porn

SIR – The true scandal of Operation Ore is that millions of pounds of public money and thousands of police hours are being squandered on a grotesque public circus (“Buried by a pile of porn”, January 18th). Mass arrests and public humiliation of individuals who are doing no more than indulging in voyeurism behind closed curtains may well provide juicy copy for the tabloids but it could well infringe the European Convention on Human Rights, which guarantees the right to privacy in one's own home. There is much distasteful and contentious material on the internet but in only one instance does the state reserve the right to smash down the doors and ruin the lives of people suspected of exercising their natural curiosity.

It should be evident to any but the most obsessive abuse lobbyist that a penchant for certain forms of erotic material is not restricted to a small, marginal group of shabby, low-life perverts but widely prevails at all levels of society. Attempting to eradicate it with ham-fisted legislation and bully-boy policing will have as much success as trying to curb the widespread use of cannabis by the same misguided means.

Adrian Marlowe
Amsterdam

Nuclear testing

SIR – You opine that it is illogical for President George Bush to refuse to send the Comprehensive Test Ban Treaty up for ratification ("Holding the line", January 18th). What is illogical about a nation wanting to keep its powder dry?

I was a member of the United States delegation negotiating this treaty, along with the British and the Soviets, so I am more than casually aware of the issues involved. It is public knowledge that nuclear warheads, which are complicated devices, deteriorate at unknown rates, and in unpredictable ways. At some point, some stockpiled weapons will cease to be functional but nobody will know which ones and when. The Russians know this well. A few years ago, some of their weapons stockpiled in the Ukraine began to deteriorate to the point where they were generating heat. That is scary.

Because of the numerous unknowns involved, our stewardship programme, which attempts to predict stockpile reliability by means of massive computer power, cannot succeed. The only way to be sure is to test periodically a sample of each of the weapon classes in the stockpile.

Tom Sherman
Michigan City, Indiana

Fine kettle of fish

SIR – A solution to the zander problem could be to persuade British anglers to refrain from returning their catch to the water and instead take the zander home and eat them ("Red in tooth and claw", January 18th). The fish are a delicacy in Munich costing up to three-times more than trout and taste much better. They should be filleted, coated with seasoned flour and fried in butter, then served with boiled potatoes and a vegetable. A dry white wine goes well as an accompaniment.

Dave Tanner
Munich

Building a union

SIR – As currently conceived, any Palestinian state on parts or all of the West Bank and Gaza strip is scarcely viable ("It should have been so simple", January 25th). Worst of all, such an accommodation would recognise further, accept and entrench the separation of people along racial, ethnic, religious and political lines. This will never be a sound foundation for peace.

There is a "high road" in the Middle East, and it looks much the same as everywhere else. All residents enjoy equal rights as citizens, the government represents the people, and there is religious tolerance, and freedom. The ideas now holding sway on all sides of the conflict are anathema to these basic principles. The answer could take the form of a Middle Eastern Union, along the lines of the European Union. The core would comprise Israel-Palestine and Jordan, but would be open to other countries in the region, especially Syria and Lebanon.

Christian Eigen-Zucchi
Washington, DC

Bail out Bolivia

SIR – Bolivia faces the challenge of managing domestic development under the triple pressure of the international drug trade, domestic recession within a regional crisis and a growing culture of protest, as you say ("Coca and socialism", January 25th).

Bolivia has made a genuine effort to put an end to the drug problem, incurring high economic and social costs. The lack of appropriate international support has created a sense of frustration among the population, which has led to social unrest. At its root is the fact that rural people remain deeply impoverished, even after two decades of democracy and 17 years of IMF-backed structural reforms. Therefore, our first concern is the economic crisis, which has placed the country on the verge of a disaster. We hope that the international community—using trade, investment and technical assistance as contributions to development—will be as effective and vocal in our country as those who have taken up the anti-globalisation banners.

Jaime Aparicio Otero
Bolivian ambassador
Washington, DC

Corps competence?

SIR – It is probably an understatement that $8 billion might not be enough to restore the Florida Everglades ("Going with the flow", January 18th). Broadly speaking, two parties are responsible for the failing ecosystem: sugar growers and the Army Corps of Engineers. Putting one in charge of restoration so the other can continue its business is a recipe for failure.

Nature is adept at taking care of itself if only we would let it. Rather than spend billions on adjusting water levels, we should divert the money already spent on subsidising sugar growers into buying them out. Simply ceasing to pollute could easily turn the tide for the Everglades, and at far lower cost. Only after this is given a fair chance to work (say 10 years) should we permit the foxes of the Corps of Engineers back into the henhouse. The corps, whose motto is "enhancing the environment" has led to many of the environmental problems we now face.

William Trent
Hoboken, New Jersey

Sparkling prose

SIR – You say that 1978 was a time "before the internet was even a twinkle in Al Gore's eyes" ("Face value", January 25th); that Ralph Nader was agitating "before the shenanigans at Enron were even a twinkle in Kenneth Lay's eye" ("Fighting for his life", January 25th); and that more litigation is "so far only a twinkle in the eyes of the Securities and Exchange Commission and [Eliot] Spitzer" ("But which way is up?", January 25th).

I cannot imagine that your paper is composed entirely by one overworked writer and so must suppose that the repetition is deliberate. Are you in the pay of security services, sending cryptic messages to operatives through stylistic code? Or are you deliberately trying to drill your non-native English readers with one idiomatic expression each week?

Jaroslaw Czarnecki
Chicago

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Dealing with Iraq

The case made clearer

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From The Economist print edition

AP

Colin Powell's evidence against Saddam Hussein was compelling in some aspects, thin in others

> "About this committee that is coming...with Mohamed ElBaradei [the head of the International Atomic Energy Agency]...We have this modified vehicle...What do we say if one of them sees it?"
>
> "You didn't get a modified...you don't have a modified...?"
>
> "By God, I have one."
>
> "Which? From the workshop?"
>
> "From the al-Khindi company."
>
> "What?"
>
> "From al-Khindi."
>
> "...I'll come and see you in the morning... I'm worried you all have something left."
>
> "We evacuated everything. We don't have anything left."

Get article background

THAT was an extract from a conversation between a colonel and a brigadier-general in Saddam Hussein's Republican Guard, intercepted by American surveillance and presented by Colin Powell to a meeting of the United Nations Security Council on February 5th. The conversation, he said, took place on November 26th, the day before the United Nations resumed weapons inspections in Baghdad. It was among the most striking parts of a speech in which the secretary of state sought to persuade the council—and, by extension, world opinion—that time has run out for Mr Hussein.

Perhaps the most compelling part of Mr Powell's speech described Iraq's repeated lies to the weapons inspectors. He used intercepted conversations (which Iraq said were fakes) to show that the Iraqis possess equipment they know to be banned, and are hiding it. He claimed that the hard drives of

computers in scientific establishments had been removed, and that Iraq's secret service puts the weapons inspectors under constant surveillance; and he gave more details of a committee to inspect the inspectors, chaired by Iraq's vice-president and including Mr Hussein's son, Qusay.

Mr Powell said Mr Hussein himself is involved in coercing the Iraqi scientists to whom, under Resolution 1441, Iraq had promised the weapons inspectors immediate, unimpeded and private access. His spies have threatened to kill those scientists and their families if they co-operate, and have said that anyone who leaves Iraq will be treated as a traitor.

But Mr Powell also produced a series of photographs which, he claimed, showed not just military and scientific files being driven around the countryside—that, too, was known—but rocket-launchers and warheads. A pair of photographs of a chemical munitions site in Taji, one of 65 in the country, was suggestive. In the first, you could see a decontamination vehicle and a monitoring facility which checks for leaks, evidence that the site had been recently in use. The second photo showed the same site on December 22nd. The decontamination vehicle and monitoring shed had gone—just as a convoy of weapons inspectors was shown arriving. Another pair of photos, this time also supported by an eye-witness account, showed a chemical-weapons transport site: first in operation, then closed down and with the topsoil removed.

When Mr Bush first took America's case to the UN in September, the Americans hoped the weapons-inspection process might work in one of two ways. Perhaps Saddam might disarm voluntarily, and war would be avoided. Or, more likely, the inspectors would find him guilty of cheating or evasion under Resolution 1441, and the Security Council would permit the use of force.

For those who believe the burden of proof is on Iraq to show it is complying with Resolution 1441, Mr Powell's case looked powerful. On their view, the job of the inspectors is not to find weapons, but to verify that Mr Hussein is co-operating by disarming. He has not merely failed to prove he is complying; Mr Powell has shown he is actively seeking not to comply. In the secretary's words, “Iraq is now in further material breach of its obligations.” And it must be hiding something.

But that is not yet the interpretation of the French and several other Security Council members. For them, the main issue is not disarmament, but whether Iraq is building weapons of mass destruction. They argue that the inspectors should be given more time to find out, and that, so long as inspectors are in Iraq, Mr Hussein will be contained. This view puts the burden of proof on the inspectors and on those who want Mr Hussein out. Much of Mr Powell's speech was therefore devoted to describing Iraq's weapons programme.

What Iraq is hiding

The secretary of state gave further evidence that Iraq has germ-warfare factories mounted on trucks and railway carriages. Some details were already known from a chemical engineer who defected and, in 2000, described an accident involving biological agents.

To this Mr Powell added three more sources, including a civil engineer and a defecting major, who corroborated the engineer's account of factories on trucks. He played another intercepted conversation in which one Republican Guard told another to remove the expression “nerve agents” whenever it cropped up in wireless instructions. Mr Powell said Iraq has about seven mobile bioweapons laboratories or factories, with two or three trucks each—as few as 18 trucks in all, easy to hide among the thousands on Iraq's roads.

Next, Mr Powell argued that Iraq's chemical-weapons programme would be almost impossible for inspectors to find because, to all outward appearance, its facilities look like chemical factories. Indeed, they are chemical factories, in which “illicit and legitimate production can go on simultaneously; or, on a dime...turn from clandestine to commercial.” With facilities like these, he implied, it would be pointless to give the inspectors more time.

Perhaps the most contentious part of Mr Powell's account of Iraq's weapons programme concerned its attempt to build a nuclear bomb. Before the speech, many administration officials had been playing down this threat, and Mr ElBaradei said last week that he had found “no evidence that Iraq has revived its nuclear-weapons programme.” But Mr Powell was adamant: “Saddam Hussein is determined to get his hands on a nuclear bomb.”

His argument rested on evidence that Iraq is still seeking the one missing piece needed to build a nuclear weapon: highly enriched uranium. Uranium can be enriched through a gas-centrifuge process. He said that in 1999 and 2000 Iraqi front companies had tried to buy a factory that produces magnets used in the process, and that Iraq had later sought machines that balance the gas-centrifuge rotors.

Mr Powell also returned to the vexed question of Iraqi imports of high-specification aluminium tubes. Admitting that Iraqi and IAEA scientists say these tubes are for conventional rockets, Mr Powell reasserted America's view that they are more probably intended as centrifuges. American agents, he said, had secretly inspected some of the tubes before they reached Baghdad and had found that each batch had been milled to higher and higher specifications. Why go to all that trouble, asked Mr Powell, if the tubes were just to be blown up in a rocket?

This part of the speech was a mosaic of circumstantial material, rather than an Adlai Stevenson-like blaze of proof. First responses suggested Mr Powell had not instantly changed any minds. The Russian and Chinese foreign ministers suggested the inspectors should be given more time; the French suggested their numbers should be doubled or tripled. But these comments were prepared beforehand. The more intriguing question is whether Mr Powell's speech—along with a second report to the council from Hans Blix, the chief of the weapons inspectors, on February 14th—may still rally support behind a war by paving the way for a second Security Council resolution.

Almost all parties in the dispute have their own reasons for wanting such a resolution. Even American officials, who were saying a week ago they did not need one, now take the line that a resolution would be welcome so long as it did not produce endless delay. The American public says it strongly prefers war with allied backing, and American forces are not yet fully ready for action anyway. So the administration has time to look for UN support.

Britain's Tony Blair is a strong supporter of a second resolution, if one can be had, to settle opposition at home. A similar calculation may be in the minds of several Arab regimes. Despite public criticism of Mr Bush, their biggest private fear has been that he could flinch at the last minute, leaving Mr Hussein with soaring prestige in the Arab world. A second resolution would help them with their own people.

More intriguing are the interests of France and Russia. Though they want to give the inspectors more time—implying there is no need for a second resolution yet—they have to balance this against fear that America might go it alone and spurn the Security Council, which is a useful mark of their remaining global influence.

The biggest problem with a new resolution is timing. The Americans want one soon, while the French are in no hurry. It is also unclear what a new resolution would say: whether it would issue an ultimatum, or whether it would declare a “material breach” and let member states take the necessary action. Thanks to Mr Powell's speech, the UN debate now revolves round these two matters; and on the size of the coalition behind what looks, day by day, like inevitable military conflict.

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Iraq and al-Qaeda

Imaginary friends?

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The weakest part of the case for war

Get article background

IT SEEMS an unlikely alliance. Al-Qaeda's troops are Islamic extremists; Saddam Hussein is a secular despot. Yet the notion that these two enemies of America are in cahoots has become a plank in the case for war. Despite Colin Powell's best efforts, it is a wobbly one.

The theory is old. A reported meeting between Mohammed Atta, leader of the September 11th terrorists, and an Iraqi spook in Prague seemed to clinch the case—but it now seems to have been apocryphal. The charge now largely rests on two related bits of evidence.

Exhibit A is Abu Musab al-Zarqawi, an al-Qaeda terrorist and reputed expert in poisons, known to have had medical treatment in Baghdad. Mr al-Zarqawi is implicated in the murder of an American diplomat in Jordan last year. Mr Powell alleged that he is involved with a network of Islamist plotters in Europe, and that Baghdad shelters his associates.

Exhibit B is Ansar al-Islam, an Islamist group waging a mini-war against Kurdish forces in northern Iraq and thought to harbour al-Qaeda fighters. The region is beyond Mr Hussein's direct control; but Mr Powell said that one of the group's leaders is an Iraqi agent, and that Mr al-Zarqawi's men established a poisons training camp in the area.

Mr Powell also accused Iraq of training al-Qaeda in various dark arts, providing more details of these claims than has previously been proffered. It is fair to assume that Mr Hussein's regime knew about Mr al-Zarqawi's presence in Iraq. Still, compared with the other elements of his case, Mr Powell's proof was slim. Al-Qaeda is not a conventional organisation, so meetings between its “members” and Iraqis may not be conclusive. Much of the relevant intelligence comes from captives, who may be saying what they think their captors want to hear, or may even be hoping to provoke a war.

In fact, this is a good example of how inconclusive intelligence can be. Before September 11th, the evidence of active Iraq-al-Qaeda collusion looked flimsy; since then, American sensitivity to unpredictable threats has made it seem much more alarming. British politicians have also advanced the theory, if more cautiously; but multiple leaks attest that British spooks, who claim to have given the UN weapons inspectors some of their best leads, are extremely sceptical.

The thought that Mr Hussein, his weapons and al-Qaeda might combine is indeed terrifying. Mr Hussein continues to give succour to various terrorist organisations, and may hope that they will rally to his cause in the event of war. Perhaps it was indeed naïve to assume that al-Qaeda and Mr Hussein couldn't bury their ideological hatchet; perhaps, as Mr Powell said, ambition and hatred are enough to bring them together.

But introducing this supernumerary charge has probably added little to America's case. After all, several other governments and failed states have more concrete links to al-Qaeda. And by adding this extra facet to its argument, America has partly shifted the burden of proof from Mr Hussein to itself.

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Iraq's humanitarian needs

If things go badly...

Feb 6th 2003
From The Economist print edition

The set-up in Iraq renders its civilians particularly vulnerable in war

AP

The young suffer first

MANY aspects of the war hanging over Iraq are unpredictable but one is not: the unusual vulnerability of the civilian population. There are two reasons for this. First, about 60% of the population, or 16m people, are 100% dependent on the central government for their basic needs; they survive only because the government provides them with a food ration each month. Second, after two wars, decades of misgovernment and 12 years of exacting sanctions, there is no fat to rely on.

In last year's Afghan war, as in the 1991 Gulf war, more people died from the indirect results of the conflict than from the fighting itself. And Iraqis now are far less able to get by. In 1991, most of them were in work, enjoyed fair health and had material assets; now, more than 50% are thought to be unemployed and most people have sold just about everything they once had (visitors gauge this from the markets, where the goods for sale are increasingly dilapidated). Though conditions have improved since the oil-for-food programme was set up in 1996, the report of an International Study Team*, academics and doctors with mainly Canadian backing, that visited Iraq at the end of last month found how vulnerable Iraqis still are. Most face grinding poverty, and children, in particular, are terrified at the prospect of war.

Estimates by Unicef, the UN's childrens' agency, show close to a quarter of children under five suffering from malnutrition, some of it acute. A leaked report reveals that the UN is working on the calculation that, in war, some 5.4m Iraqis will need emergency help from outside, with small children needing it most. The World Health Organisation's contingency plans allow for the emergency treatment of 100,000 people injured by bombing, and for another 400,000 who may need medical aid if they cannot get food or clean water or shelter. The problems, already vast, would swell exponentially if the fighting is prolonged and people flee the cities.

Food is the prime concern. The Iraqi rationing system works very efficiently (its database also allows the regime to keep tabs on everybody). In the northern Kurdish enclave, the food—flour, pulses, cooking oil, milk powder, all of it imported—is distributed by the World Food Programme (WFP). In the rest of the country, it is distributed monthly by local merchants.

Since August, the government has been providing an extra month of rations in advance to allow

stockpiling. But supplies are running out, and people have not even been getting their full ration. Moreover, there is much anecdotal evidence, particularly in poor areas, of people selling their extra rations for medicine and other basics. The collapse of central government could bring distribution to a stop. So could bombing, if it disrupts transport: for instance, Iraq is trisected by two rivers that flow north-south, so blown-up bridges would halt all east-west traffic.

Another danger: if power stations are blown up, it could mean the collapse of water and wastewater systems, which, in turn, would have profound consequences for public health. Iraq's water and sewerage have never fully recovered from the crippling of the electricity system in 1991, plus neglect and the difficulty in getting spare parts and chlorine. Some of the water-treatment plants, and the big hospitals, have standby generators, but only 10% of the sewage-pumping stations have them. In any event, says Oxfam, a British charity, most of the generators do not work. Even as things are, the power system is crumbling, with only 60% of the country's needs being met. Further destruction could be calamitous.

Both the UN and non-governmental organisations (NGOs) have started to face up to the crisis, but have difficulty planning for an emergency that has not yet happened and which nearly all hope can be averted. Co-ordination has to be low-key. The WFP, already overwhelmed by the famines in Africa, is pre-positioning food stocks in the region which it calculates would feed 900,000 people for three months (as with all UN agencies, its expatriate staff would be pulled out of Iraq once war started). Appeals for money also have to be low-key. So far, the WFP has had “informal” pledges for only $7m.

Eclipsing this sort of money are America's multi-billion-dollar schemes for reconstructing a post-Saddam Iraq. Working with a civilian UN administrator, America plans to flood the country with food and medicine and to rebuild the infrastructure it may be about to destroy—much of it painstakingly rebuilt after the bombing in 1991. The NGOs, which have been gathering in Jordan as the expected gateway for aid, were this week given a pep talk by senior American officers. They were told that an American Humanitarian Operations Centre may be established in Jordan or Kuwait, and that “safe havens” would be established for NGOs in Iraq.

The agencies were uncertain, calculating the problems of operating under America's military umbrella. Aid and tanks are uneasy partners, and they wonder whether they would be allowed to operate outside the safe havens, In the end, if America occupies Iraq, the agencies will have no choice, and the dollars will be welcomed. The Americans claim that they are planning intensively for the short term as well. They had better be right.

“Our Common Responsibility: The Impact of a New War on Iraqi Children”. International Study Team, January 30th 2003. (For the electronic version, see www.warchild.ca).

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The budget

The torch has been passed

Feb 6th 2003 | WASHINGTON, DC
From The Economist print edition

George Bush's radical new budget would make Ronald Reagan smile

Get article background

FOR the past two decades, Ronald Reagan's budgets have set the standard for radicalism in American fiscal policy. Conservatives eulogise the Gipper's tax cuts; Democrats decry the deficits that exploded on his watch. If the budget that George Bush unveiled on February 3rd is enacted in anything like its current form, it will match Mr Reagan's efforts for boldness. With little fanfare (since it was overshadowed by both *Columbia* and Colin Powell), Mr Bush's third budget proposes a radical reform of America's tax code and a dramatic reorganisation of how social services are provided; if enacted, it would also add to the prospect of long-term budget deficits.

Tax cuts are the centrepiece of this budget. Unlike the Gipper, who clawed back some of his landmark 1981 tax cuts in subsequent years as deficits ballooned, Mr Bush wants another round of tax cuts worth $1.3 trillion over the next ten years. As he promised last month, he wants to make permanent the 2001 tax cuts, which currently expire at the end of 2010. He also wants to accelerate the income-tax cuts, child tax credits and other reductions that appear gradually over the decade. And, most controversially, he wants to end the double taxation of dividends. But the budget does not stop there.

The Bush team wants to overhaul the savings industry, replacing the current mosaic of tax-sheltered schemes with three simple accounts—two for individual savers and one for plans sponsored by employers. Any American resident, regardless of age or income, could put up to $7,500 a year in a “Lifetime Savings Account” (LSA), from which tax-free withdrawals could be made at any time. A further $7,500 could go into a “Retirement Savings Account” (RSA), where all withdrawals would be tax-free for anyone over the age of 58. The plethora of job-based retirement plans would be simplified and consolidated.

Mr Bush says this is just revamping the current system. In fact, it is much more ambitious. By greatly increasing the amount of money that can be put into tax-sheltered accounts, and by lifting all income limits on who can use them, his team would sharply reduce the taxation on saving. Together with the elimination of dividend taxation, these proposals would ensure that most Americans would no longer pay any tax on their savings. America's personal income tax would, in effect, become a wage tax, and the country would have taken a huge step towards a consumption-based tax system.

The goals of such a shift—higher saving and thus stronger economic growth—are laudable. But unlike the many plans that radical tax reformers have touted in recent years—and unlike Mr Reagan's 1986 tax-reform package—Mr Bush's proposals make no effort to be revenue-neutral. In the short term, the new savings vehicles would actually add to the government's coffers as Americans convert their savings from existing schemes (on which tax has not been paid) to the new accounts. But since all withdrawals from the new accounts will be tax-free, the long-term effect will be less money for the government.

The budget contains few proposals to claw back money elsewhere, even though some such measures would be sensible tax reforms in their own right. Tax deductions for, say, mortgage interest or charitable donations have not been reduced or eliminated; rather, they have been expanded and joined by new deductions.

Mr Bush's fiscal conservativism, as far as it goes, is reserved for the spending side of the budget. At first sight, this offers no big surprises: a modest 4% increase in overall discretionary spending (that is, spending outside Medicare and Social Security) and a shift in priorities towards security. Most of the increase goes to the Pentagon, which gets $380 billion in all. Mr Bush has allowed for higher pay, new ships and fighter jets and a big jump in spending on missile defence, but the budget includes no provision for the cost of a war in Iraq; and, regardless of a war, the Bush team is expected to ask for more defence money later in the year.

Homeland security gets a big boost. The 22 government agencies that recently merged into the new Department for Homeland Security get $36.2 billion, a 7.4% increase in their funds. Plenty more money goes on foreign aid, as Mr Bush begins to pony up the $15 billion he has pledged to fighting AIDS over the next five years. And military veterans get a lot more to pay for their health costs.

Everywhere else, however, the squeeze is on. Only two departments—Labour and Justice—see outright declines in their funding. But in most cases the budget proposes rises at, or below, the rate of inflation. After the spending binge of the late 1990s, such restraint will be tough for the big domestic departments.

Behind this brutality lurks further radicalism. Mr Bush wants to revamp the way that some social services are provided. Potentially the biggest change is in Medicare, the huge government medical plan for old people. Mr Bush's budget candidly admits that Medicare faces unfunded liabilities of about $13.5 trillion. His solution is still sketchy, but the basic idea is to spend $400 billion over the next ten years providing a prescription-drug benefit to encourage old people to enrol in competitive and less costly health-care plans.

Whittling down government's role

This strategy of cash today for reorganisation tomorrow also applies to Medicaid, the health-care programme for poor people, which is paid for jointly by the states and the federal government. Mr Bush wants to change the structure of federal payments to the scheme. For the next seven years states would get more money, but in return there would be long-term limits on federal support.

The budget also wants to revamp job training and unemployment benefits as well as Head Start, the pre-school programme for poor children, largely by shifting responsibility to the states. Moreover, Mr Bush wants tougher monitoring of who is eligible for free school lunches, refundable tax credits and other benefits targeted at the poor. The official goal is to make America's safety-net more efficient. It should also reduce the federal government's involvement.

It won't balance the books, though. Mr Bush's budget documents show what his rhetoric denies: deficits are set to stay. Next year, his team expects a deficit of $307 billion. At just under 3% of GDP, that is very much worse than they forecast only six months ago, but still relatively modest compared to the early Reagan years, when the deficit hit 6% of GDP (see chart).

By 2008, the last full year of the Bush team's forecast, the budget deficit is expected to be just under 1.5% of GDP. That is modest, too, but extremely unrealistic. It excludes the cost of an Iraq war, the cost of fixing the alternative minimum tax (which everyone knows must happen and which could cost $500 billion over ten years), and the cost of modernising Social Security, another huge

reform that Mr Bush has surely not forgotten about. Besides, the full impact of the lost revenue from many of Mr Bush's tax cuts will not kick in until well after 2008, when this budget conveniently stops.

The prospect of long-term deficits has set the Democrats howling. John Spratt, the top Democrat on the House budget committee, has called the budget "the most damaging in US fiscal history." Tom Daschle, the Senate minority leader, has dubbed it "a budget-busting epic disaster". Even many Republicans are uneasy about the fiscal effect of more big tax cuts—especially Mr Bush's plan to eliminate the taxation of dividends.

All of which suggests that Mr Bush won't get all he asks for in this budget. But the truth is that even if Congress waters it down, this budget is likely to mark a substantial shift of fiscal priorities. America appears to be heading not just towards neo-Reaganism, but quite possibly towards something beyond it.

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Impoverished cities

Governor, can you spare a dime?

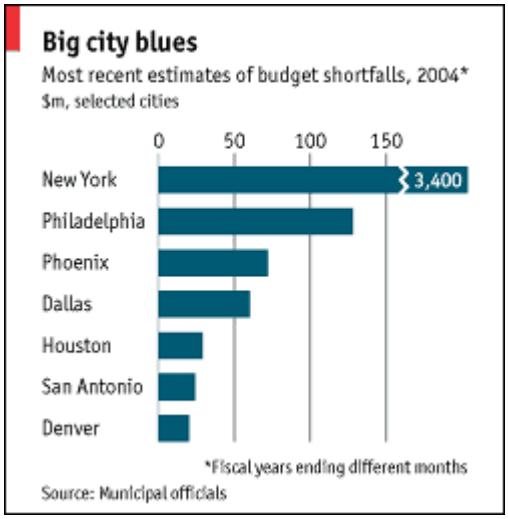
Feb 6th 2003 | NEW YORK AND WASHINGTON, DC
From The Economist print edition

Hard times for city mayors, with little help from state or federal government

THE life of a mayor is seldom glamorous. There's too much bureaucracy, not enough swagger. These days the drudgery at city hall is worse than ever. Across America, mayors are fretting their days away trying to rub out budget deficits, which most state constitutions do not allow them to have. They also have to contend with rising urban job losses, and ruthlessly cut the services they provide. Some must be dreaming of freedom from their wretched lot.

The states' fiscal troubles have hit the headlines. But the crisis in America's cities is equally acute. Worst off by far is New York City. The budget proposal unveiled last month by the mayor, Michael Bloomberg, makes depressing reading. It is a basket of pleas to the state for commuter taxes and aid, and threats to collect more money from parking tickets, all to cut the city's $3.4 billion deficit next year.

But it's not just New York. Most other cities are struggling to subsist on falling tax revenues (see chart). Some, like Philadelphia, have dipped into reserves built up during the good times. Others have slashed spending or raised what taxes they can. Cameron Whitman of the National League of Cities (NLC) says that one in four American cities is now worried about meeting debt-servicing requirements. So far bond ratings have held stable, except in a handful of smaller places such as Atlantic City and Trenton in New Jersey. Among bigger cities, Dallas and New York have a negative credit outlook from S&P. Other cities' ratings could slide as states withdraw their local support.



Meanwhile, urban job losses are mounting. A new report by the Conference of Mayors says that American cities lost 646,000 jobs last year. This year looks little better.

In some ways, cities may be even more vulnerable than states. A good chunk of cities' revenue—13% on average, and often much more—comes directly from state aid. This is given grudgingly at the best of times. Now, with the states themselves facing gigantic deficits, some cities may see this help reduced. Massachusetts, which accounts for 26% of Boston's revenue, plans a 2.5% cut in direct state aid to cities and towns. In Connecticut the governor wants to reduce state aid to local authorities by $200m. Angry cities and towns are taking the state to court to try to get what they say it owes them.

Other sources of revenue have been drying up as well. As consumer spending has slowed, sales taxes and imposts on entertainment and tourists have suffered, says Chris Hoene of the NLC. Property taxes are usually a big earner for municipalities, but some cities are not allowed to raise them without the approval of voters or the state legislature. In California a 1978 ballot initiative, Proposition 13, sets a cap at 1% of assessed value. There are grumbles in city halls about George Bush's proposal to eliminate the dividend tax, which would make city bonds, like state bonds, less attractive, and reduce tax revenue.

At the same time, homeland-security costs are mounting—and cities have taken their begging bowl to Washington. Since the terrorist attacks of September 2001, the federal government has been telling local governments that it will help to pay for more policemen, bioterrorism equipment and so on. But only the barest trickle has arrived, and cities have been paying out of their pockets—a total of $2.6 billion, they say—while cutting other services. Baltimore has splurged on radiation-detecting equipment to test water systems. Even Anchorage, in Alaska, has shelled out to change security codes at many public buildings.

Rather than counting on dribbles of federal aid (which currently accounts for about 2% of cities' intake), mayors have resorted to all sorts of schemes to plug the holes. In New York Mr Bloomberg raised property taxes 18.5% last year. Cincinnati is privatising jobs such as street-sweeping to help cover its deficit. Last year Pittsburgh even talked of declaring itself bankrupt (sort of), in which case it would have to be taken over by the state. Instead, the mayor is resorting to tax rises, including a controversial proposed 10% tax on drinks.

The most creative city has been Detroit. Last year it was able to wring more than $100m out of three casinos that will be permitted to build small hotels in time for the 2006 Super Bowl. That helped to get rid of Detroit's $94m gap, fast.

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Criminal pursuits

Prickly business

Feb 6th 2003 | AUSTIN
From The Economist print edition

A new endangered species: south-western cacti

THINK of Texas, and (after Stetsons, oil and cattle) a large barrel cactus may come to mind. Now the famously tough and spiny plant faces a new problem: cactus rustlers. The Texas barrel, the yucca, the ocotillo and other large, slow-growing cacti are being dug up by the truckload and resold at nurseries and novelty shops around the country.

The problem is particularly acute in the Chihuahuan desert, which runs across Texas, northern Mexico and parts of Arizona and New Mexico. The desert is home to a quarter of the 1,500 cactus species known to man. According to a new report by the World Wildlife Fund, the illicit trade "may be significant enough to destabilise wild populations of some species."

This once lowly plant—loathed by ranchers, since it hurts cattle and is hard to kill—has become a victim of its own success. With fresh-water supplies tighter than ever in the West, the unthirsty cactus has become the ideal bit of green for landscapers to plonk in gardens. Cacti also feature in trendy skin-care lotions, drinks and herbal remedies.

Some criminals focus on smuggling them from Mexico. In 1999 two men were sent to jail for hauling into Texas more than 20,000 Mexican cacti, worth $500,000. Most prefer just to rip them out of the ground in Texas. It is hard for the authorities and landowners to police the emptiness; and besides, many ranchers are only too willing to offer a cheap supply to anyone with a shovel.

One reason why the cactus trade is now centred on Texas is that the plants are better protected in California and Arizona. Eliot Shapleigh, a Democratic state senator from El Paso, wants to tighten up the rules for private collection, so as to find out how many cacti are disappearing with the landowner's permission and how many are not. But, as he admits, West Texans dislike government interference as much as, or even more than, they dislike cacti.

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Turkey's new government

Not enough cleaning yet

Feb 6th 2003 | ANKARA
From The Economist print edition

The “clean” party that now governs Turkey is not living up to its name

Get article background

AFTER years of ineffectual rule by assorted coalitions, Turkey got a single-party government after the Justice and Development Party (AK) swept to power with 34% of the vote last November. The party (whose initials spell *ak*, “clean” in Turkish) looked well placed to root out corruption, sort out the economy, drive through a deal to reunify Cyprus and accelerate reforms at home to secure eventual entry into the European Union. Three months on, such hopes are fading. “This is one of the weakest and clumsiest governments we've ever had,” says Cuneyt Ulsever, a commentator for the daily *Hurriyet*, and until recently a vocal AK enthusiast.

That may be unfair. Power came at a bad time for the AK. Against most Turks' wishes, the country is about to be dragged into the attack on Iraq. Time is running out for a deal in Cyprus, after decades.

On both issues the AK has tried to be bold. The prime minister, Abdullah Gul, had defied intense pressure from Washington to let thousands of American ground troops be deployed in Turkey, until he started this week to give way to Mr Bush. On Cyprus, Tayyip Erdogan, the AK's chairman and real leader, has embraced the latest UN peace plan, defying his generals and accusing the Turkish-Cypriot leader, Rauf Denktash, of obstruction.

It is on the economy that AK is floundering; so much so that the IMF has delayed releasing its next loan tranche of $1.6 billion until the government proves it is serious about reforms. The main test is the Fund's target, 6.5% of GDP, for its “primary” (ie, before debt-service) budget surplus. To reach that will mean further cuts in spending—and reneging on pre-electoral promises of relief to the millions of civil servants, pensioners and unemployed, who helped propel the AK to power. The government has yet to come up with convincing evidence that it can meet the target. Meanwhile, it has raised pensions, claiming it can pay for this through a tax increase on tobacco and alcohol.

The measure has brought its beneficiaries little relief. Wholesale prices surged by 5.6% in January, thanks notably to higher oil prices. The government is pledged to cut annual consumer-price inflation to 20% from the 30% recorded at the end of 2002. That looks unlikely.

On top of this, the IMF disliked a bail-out deal last week by the banking-watchdog agency with Mehmet Emin Karamehmet, owner of Pamukbank, a failed bank seized by the agency in June. He is alleged to have siphoned vast sums out of it and another bank that he controlled into his other companies. He is also a media magnate. The government rescued him, claim his rivals, in exchange for backing from his newspapers and television channels.

Mr Erdogan said that the watchdog had worked out the deal on its own. But he then added that the independence of such agencies needed to be reduced by bringing them under political control, triggering fresh wrath at the IMF.

Openness is not, it seems, a priority for the government. It has shelved plans to end the immunity from criminal charges enjoyed by members of parliament. And it is talking of revising a public-procurement law brought in by the previous government, under EU and IMF pressure, that makes it very hard to rig public contracts. The idea is to exempt municipalities—which account for some 70% of these contracts. In sum, not a very *ak* picture.

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Spain and its Basques

No truck with terrorism

Feb 6th 2003 | MADRID
From The Economist print edition

The central government is determined to smash ETA by war, not jaw

Get article background

Reuters

How Aznar feels about the Basques

"Everything to do with the banning [of Batasuna] is aimed at taking away the vote from so many thousands of people who have a legitimate political choice. They can count on our moral support." That was the pledge last weekend to the supporters of ETA's now-banned political wing from Xabier Arzalluz, leader of the non-violent Basque Nationalist Party (PNV). To many it sounded like an appeal for votes. To Spain's prime minister, José María Aznar, it confirmed his conviction that Mr Arzalluz and his party are hand-in-glove with ETA's gunmen. With views so wide apart, can the central government ever reach agreement on the future of the Basque region with the PNV government that runs it? And does Mr Aznar have any long-term policy for it other than smashing ETA and demonising the PNV?

The short answer to both questions is most probably no. Local elections, the first since Batasuna was banned last summer, are due in the region in May. The PNV regional premier, Juan José Ibarretxe, has said that this year he will put his plan for a referendum on whether the region should become a "free state associated with Spain" (and perhaps sharing the Spanish king) to the Basque assembly. He claims this would lead to an ETA ceasefire and the prize of greater autonomy. Mr Aznar sees the idea as a threat to Spain's territorial integrity and a sop to ETA.

Yet for all the climate of fear created by the terrorists, for the past month the steep green hills and narrow industrialised valleys of the Basque country have been free of ETA's bombs and bullets. The last murder was in December, when a police officer trying to spot-check a car that was, in fact, carrying explosives to Madrid, was shot dead. French and Spanish police, who last year arrested about 190 real or alleged *etarras*, 60 of them in France, have grabbed another dozen more this year. Politicians are yet again speculating, albeit cautiously, on the prospect of eliminating ETA.

That is unlikely: the serpent's head has proved itself in the past capable of quick regrowth. Mr Aznar, pledged to step down early next year, is determined to try to cut it off for good. After the breakdown of a 14-month ceasefire in 1998-99, he ruled out any further attempts at dialogue with ETA. Many doubt that his iron-fisted policy can resolve the long-term Basque problem, but it is popular in a country that has grown sick of ETA's violence.

He is backing tough police action with tougher laws: a new one has just raised the minimum prison term for ETA terrorists from 30 to 40 years. And in a further show of determination, Mr Aznar recently said he would stand as a councillor for his People's Party's in the Basque city of Bilbao. It's a gesture, he admits, "a symbol of solidarity" with local councillors who work under threat of death, as indeed they do. But, he said, he wants to show that the region must become like any other part of Spain. Just as Mr Arzalluz's firebrand nationalism reflects the Basque experience of oppression under General Franco, Mr Aznar to some extent reflects the old right wing that believed zealously in the integrity of a Catholic Spain and the use of *mano dura*, the firm hand, to ensure it.

On the political front, some form of protest from the banned Batasuna is likely before the local elections. A new radical Basque-nationalist political formation is to be unveiled on February 16th, though no one knows whether it intends to compete in the elections But Mr Aznar said last week that he feared the PNV

more than ex-Batasuna. He suspects it may try some shock tactic, spurred both by the hope of mopping up ex-Batasuna votes and by the failure of Mr Ibarretxe's efforts to sell his idea of “association” with Spain to the region's thoroughly sceptical businessmen (and indeed even in a tour abroad).

Mr Aznar must hope that, even after its likely successes in the local elections, the PNV will not dare to call for a referendum on its association idea. But if its does? As with the rest of the prime minister's uncompromising Basque policy, says a former aide, “there is no plan B.”

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About sponsorship

Emigration from Bulgaria

Please don't (all) go

Feb 6th 2003 | TROYAN
From The Economist print edition

Too many of the brightest, youngest and best are leaving

MORE than a decade has passed since the peak of emigration from Bulgaria following communism's fall, but many of the country's most enterprising and best-educated young are still keen to seek a life abroad. Despite qualifying as economists, engineers or philologists, many of them end up—at least to start with—in menial jobs on farms or in hotels abroad. Yet the messages they send home are often surprisingly cheery, leaving their contemporaries who have stayed behind with a sense of missed opportunity and even abandonment.

Bulgaria's National Statistics Institute puts gross annual emigration since 1995 at an average of 50,000—around 0.6% of the current population of 8m. Some 40,000 Bulgarians are estimated to be living in Britain alone; demand for visas is still growing. Many newspapers in Bulgaria advertise “guaranteed visa” services, often fraudulent, on which some applicants are prepared to spend up to six months' wages. A recent survey of students in Sofia, Bulgaria's capital, suggested that 15% of them planned to leave the country, but in smaller towns and in the countryside the figure is probably much higher.

Take Troyan, a town of 25,000 some 120km (75 miles) east of Sofia. Unusually, most of its factories have stayed open, though they run at a reduced capacity and take on very few new workers. For those lucky enough find a job, wages are low: a schoolteacher's starting salary is around *euro*100 ($108) a month. The town's cinemas and nightclubs have all closed. Social life is virtually nil. Returning to Troyan after graduating, Miroslav and Miroslava Tsankova, an engineer and a language teacher, found a gloomy social void: all but a couple of their old circle of friends had gone abroad; not a single one of them was planning to come back.

Seemingly cut off from the bulk of Europe for much of the 1990s by the war in Yugoslavia, Bulgaria has missed the first wave of countries expected to join the European Union next year. The loss of qualified people may further reduce its chances of catching up.

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Charlemagne

Who speaks for Europe?

Feb 6th 2003
From The Economist print edition

France and Germany can no longer call the shots in Europe

TRUE believers in the Franco-German special relationship have a theory about why those two countries, above all others, should lead the way in Europe. In Paris and Berlin they like to argue that it is not the similarities between Germany and France that make them so dynamic a duo, it is their differences. Germany is Europe's leading industrial power, France its leading farming producer; Germany is mainly Protestant, France largely Catholic; Germany wants a European federation, France believes in the nation; Germany straddles eastern and western Europe, France is both northern and southern; Germany is yin, France is yang. You get the picture. Together, the pair encompass Europe's diversity. If these two countries form a common view, the rest of Europe can fall happily into line, confident that all conceivable interests have been taken into account.

This argument was always self-serving. But it has taken the row over Iraq to show just how out of date it is. Last week's decision by eight European countries to sign a letter of solidarity with the United States was a calculated snub to the Franco-German couple in its claim to speak for Europe. And it came just a week after that couple had renewed their marriage vows at ceremonies in Paris and Berlin and affirmed a common aversion to the idea of a war against Saddam Hussein.

The French and German leaders were taken aback by the letter of the “gang of eight”. Their diplomats insist that the Franco-German stance still represents European views more accurately than the joint letter signed by Britain, Italy, Spain, Poland, Portugal, Hungary, Denmark and the Czech Republic. The French point out, correctly, that even in the countries that signed the letter, public opinion is against war. They also argue that the eight are still in a minority in the European Union of 25 members that will come into being next year. Here, they are on increasingly shaky ground. Britain, Spain, Italy and Poland are four of the EU's six biggest countries. And since the letter was issued another ten “new” European countries, including all three Baltic and most Balkan ones, have also endorsed the American case for war. In any event, European division dramatically weakens the impression of American isolation over Iraq. But it also has big implications for Europe. The gang of eight have, quite deliberately, undermined the idea that the Franco-German couple can continue to set the EU's agenda.

France now faces an unpleasant moment of truth. It has long been queasy about the EU embracing the central Europeans. Together with Germany's reunification, the EU's enlargement threatens France's traditional domination of the club. Faced with the horror of the new Union being pro-American, economically liberal and English-speaking, its strategy has been to try to reassert the traditional leadership of France and Germany within the EU. If Germany could only be tethered to France in perpetuity, then together the pair could still set Europe's agenda.

For the last four months, this strategy appeared to be working quite well. Just before an EU summit in October, the French and the Germans grabbed control of events by cutting a deal to delay reform of farm subsidies. When Britain's Tony Blair protested, the French president, Jacques Chirac, upbraided him in front of the other leaders and postponed a Franco-British summit (which took place this week). Meanwhile Mr Chirac embraced Gerhard Schröder, the German chancellor, who has been weakened by a faltering economy and rattled by a bitter row with the Americans over his unconditional opposition to a war with Iraq. Mr Chirac pointedly remarked that it was Mr Blair who was isolated in Europe over Iraq, not Mr Schröder. Together France and Germany issued a stream of joint positions for the EU's convention on Europe's future. The lovefest culminated last month in much-hyped 40th-anniversary celebrations of their friendship treaty.

But, perhaps misled by their own propaganda about the wondrous benefits the Franco-German alliance brings to Europe, the French failed to notice how much

The French failed to notice how

the trumpeting of the duo's revived leadership role irritated other European countries, not just the traditionally isolated British. Ana Palacio, Spain's foreign minister, gave voice to widespread unease when she said this week that France's and Germany's unilateral tightening of their relationship undermined other European countries. The gang-of-eight letter was, in part, a reaction. And its implications go well beyond Iraq. It suggests that the entire French strategy for the enlarged EU is flawed. Other EU countries are simply no longer prepared to accept a Franco-German *directoire*.

much the trumpeting of the duo's revived leadership role irritated other European countries

Germany's dilemma is just as sharp. Unlike Mr Chirac, Mr Schröder has condemned the war so unconditionally that he has left himself no escape route. If, as many suspect, the French ultimately back a second UN resolution endorsing the use of force, the Germans really will be isolated in Europe. Mr Schröder's longstanding efforts to “normalise” Germany and ease it into a leadership role in the EU will have been severely set back.

Nobody's in charge

Who would then lead the new Union? The gang of eight is not an alternative leadership. If the centre-left regained power in Italy and Spain, their new governments might well be more in tune with France and Germany. The Poles may differ with the French over security but they will be with them in the battle to preserve farm subsidies. The Czechs and Hungarians are less wary of military force than the Germans but sympathise with their approach to the EU's constitutional reform. In truth, there are no more fixed and reliable alliances in the EU. Countries will team up with each other, depending on issue and circumstances. As Lord Palmerston, a British prime minister of the Victorian era, put it, there are “no permanent alliances, only permanent interests”. For all the talk of a new European way of politics for the 21st century—transcending the old ideas of national interest and sovereignty—his dictum still has a certain force.

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Financial services

Goodbye to the City

Feb 6th 2003
From The Economist print edition

The Guardian

What has happened in the City so far is bad enough, but there is worse to come

Get article background

IT IS perhaps fitting that the City of London, which became so excited by the apparently limitless possibilities of technology only a few years ago, is employing the same technology to fire those who helped boost the mania. As City firms cut staff left and right, giving the unfortunates a bin bag is only one of a myriad of ways of getting rid of unwanted staff. One poor soul, a managing director no less, who had worked for a big American bank for 16 years, was informed that his services were surplus to requirements by e-mail; another was apparently sacked by text message.

It is not just investment banks that are cutting: fund managers, consultancy firms, technology companies, lawyers: all have been wielding their axes with a will. This is unfortunate not only for those given their marching orders. The health of the City matters far more to London than Wall Street does to New York. About twice as many people are employed in the financial services industry in London as in New York. And given that financial services are Britain's biggest export earner by a long chalk, it is worrying for the economy as a whole.

No-one knows quite how many jobs have been lost. Perhaps 30,000-60,000 financial-services jobs have gone in and around the City since the downturn began a couple of years ago. Official figures are late and pretty useless: bond traders do not tend to sign on the dole. Investment banks in particular are secretive about where they are sacking people: they tend to come out with a global number. Still, Experian, a consultancy, reckons that there were about 330,000 in City-type jobs at the peak in 2000, and that around 30,000 have now gone.

The worst recession the City has ever known is the result not merely of a slow global economy, falling stockmarkets, or the prospect of war—though all play their part. The root cause of the present carnage is cost inflation that makes Hollywood or premiership football clubs look like models of parsimony.

Much of what goes on in the City is, at root, not that difficult: the firms that operate in it buy and sell things and hope to make money for their clients and for themselves. Those that buy and sell equities or

bonds do little more than estate agents, selling and buying things about which, for the most part, they have little understanding—and they are about as considerate to their customers. They do, however, earn about ten times as much. And the highest-paid rake in many times that.

Ten years ago, says a former board member at a big investment bank, a couple of people in the firm were paid $1m a year worldwide. Three years ago, he reckons that 1,000 were, and a handful earned more than $50m. He himself has an impressive pile in the country; the salary earned by his well-paid wife just about pays for the gardeners.

But the gravy train has already slowed markedly. After cutting back on swanky hired cars and telling a few poor souls to fly economy, city firms have cut back-office staff (those who settle trades), often by merging departments, and put much technology spending on hold. (At Salomon Smith Barney, for example, technology spending has fallen by up to 40%.) Out, too, have gone a few non-performing salesmen, newcomers and managing directors in areas in which business has dried up, such as mergers and acquisitions (M&A) and equities.

M&A was a very lucrative business in the go-go years, but activity in Europe fell by more than half between 2000 and 2002, from $1.2 trillion to $590 billion, and investment bankers have been sacked quicker than you could say “proposal”. And those that are left? “Instead of having a lot of people on $1m, there are a lot on $300,000,” says Martin Armstrong, a partner at Armstrong International, a headhunting firm.

Equity departments, which were also goldmines in the boom years, have been similarly hit. In general, equity-sales departments are perhaps a third smaller than they were and, says a director at one of them, “we haven't finished yet”.

Equity research is being pruned especially savagely. In 1998, Deutsche Bank was spending about $150m a year on equity research around the world. By 2000, both Deutsche Bank and Salomon Smith Barney were spending about $1 billion. Others were forking out not dissimilar sums. Telecom analysts were in particular demand. At least one London-based European telecom analyst had a package worth $25m over three years.

This extra money spent on research was essentially paid for by banks' investment-banking operations (advising on mergers and so forth), which wanted tame analysts to drum up business; investors stopped paying much for it a long time ago. And who can blame them? By the late 1990s most research was generally little more than puffery. Eliot Spitzer, the New York attorney-general, recently decreed that investment research should no longer be paid for by corporate finance. There are no such requirements in Britain, but the harsh light that has been shone on equity research has dented the demand for analysts. Many banks, says Mr Armstrong, want to cut their analyst teams in half.

Fund managers, who are doing about as badly as anybody else, are also sacking analysts. Fund managers' fees are based on the value of assets under management, and in the case of FTSE 100 stocks, this is not much more than half the level it was three years ago. Swooning stockmarkets are a particular headache for British fund managers, who have had too much invested in equities for too long, which is where many of their recent problems arise, and why almost every defined-benefit pension plan is now in trouble.

Some of the products peddled by fund managers, such as split-capital trusts, and now high-income bonds, which guaranteed income but not, alas, the return of the principal, have also been tainted by scandal. No wonder that the business of fund management is so much less alluring these days than it once was. The likes of Jupiter and Threadneedle, two asset managers, have been for sale for ages. Nobody seems interested.

Bonds are the only thing keeping investment banks afloat right now: sluggish economies and dire stockmarkets have increased the attractiveness of something that pays a fixed rate of interest. But bonds will not carry on being the money-spinner they have been for the past couple of years, because interest rates will not go much lower.

What has happened so far is bad enough, but there is worse to come. Much of the rapid expansion in capacity and pay was financed by bumper profits in the American markets. The desire to get into investment banking in general, and London, Europe's financial centre, in particular, assumed that the euro area would rival America's capital markets for profitability. It hasn't quite turned out that way, and, as the American money evaporated, the banks that once outbid each other for scarce staff are left with

huge costs and massive overcapacity. Some American banks are now talking about pulling out of London entirely: Goldman Sachs is the name most often churned out by the rumour mill.

The City's institutions now need to shrink. Properly costed, and without cross-subsidies, many businesses don't make money and never have. Who ever turned a profit on eurobonds? A few banks and fund-management firms will almost certainly exit the business—either willingly or unwillingly. Those that remain will replace the overpaid middle-aged with cheaper, younger staff. Which may not be so bad for those that have made enough money to retire on. Working for an investment bank is not much of a life.

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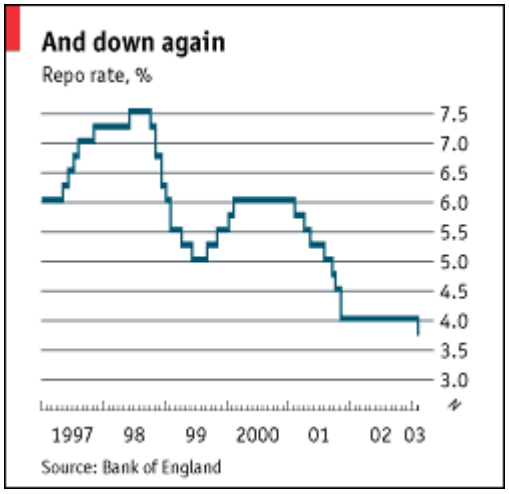
Interest rates

Back to the 1950s

Feb 6th 2003
From The Economist print edition

Why the Bank has cut rates



THE Bank of England's decision to cut interest rates by a quarter point to 3¾% brought them down to their lowest for almost 50 years. Not since early 1955 have interest rates been lower.

The Bank's decision on February 6th surprised the City which had been expecting rates to remain on hold at 4%, where they have been stuck since November 2001. For one thing, inflation is currently higher than the government's target of 2.5%: prices rose by 2.7% in the year to December. For another, the housing market continues to boom. House prices rose by almost 25% in the year to January, according to the Halifax index published this week.

In a statement, the Bank acknowledged the fact that inflation was above target but said that it expected this to be temporary. Looking further ahead, it said that the prospects for growth over the next two years, both at home and abroad, were weaker than it had previously anticipated. Hence the decision to cut rates in order to ensure that inflation would hit the target: the Bank knows that changes in interest rates take up to two years to have their maximum effect on inflation.

The outlook for growth has darkened for two main reasons. The first is that the overseas demand for exports will not recover as much as had previously been expected. Economists have been cutting their forecasts for growth in the euro area, especially in Germany. The single currency zone has been hit hard by the strengthening of the euro against the dollar. Lower demand in continental Europe will adversely affect demand for British exports, even though they will be helped a bit by recent falls in the pound against the euro. The second reason is that business investment is likely to remain more subdued than previously expected. Recent falls in the stockmarket will raise the cost of equity capital to businesses. They also cut wealth which will tend to reduce growth in household consumption.

In recent months, the Bank has been reluctant to reduce rates for fear of adding fuel to an already red-hot housing market, leading to a painful bust. It has now decided that this risk is outweighed by the risk of lower growth.

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Bradford's Muslims

Rallying to the green flag

Feb 6th 2003 | BRADFORD
From The Economist print edition

Fundamentalism and the war, as seen from Bradford's mosques

DOWN an alley between terraced houses near the city centre, the Howard Street mosque in Bradford is a tranquil place. Worshippers chat amiably to each other as they trickle in and out at prayer times. It is a long way from the strife and media frenzy around London's Finsbury Park mosque and its photogenic "hook-handed cleric", Sheikh Abu Hamza al-Masri. Few of Bradford's Muslims seem to have much time for Mr Hamza. But nerves are taut, and will tighten further if Britain goes to war with Iraq.

The removal of Abu Hamza from his Finsbury Park preaching post on February 4th by the Charity Commission occasioned little grief in Bradford, a northern town whose economy has not recovered from the decline of the textile industry. Abu Hamza, who lost a hand fighting the Soviet Union in Afghanistan and replaced it with a hook, came to prominence praising Osama bin Laden and ended his tenure at the mosque describing the space shuttle deaths as a punishment from God. The commission decided that this was so inflammatory, and his bullying of the mosque's trustees was so unacceptable, that he had to go.

Many of Bradford's Muslims would agree. "He has said that Jewish banks should be looted, but this is quite wrong," says Abdul Wadood of the Muslim Association of Bradford. Abu Hamza is thought to be of the Wahhabi sect, but, says Mohammed K. Khan, president of the Howard Street mosque: "His theocratic beliefs may be Wahhabi, but my many Wahhabi friends do not share his views."

Neither doctrinal nor geographic differences appear to matter much to Bradford's 80,000 Muslims, who make up about 20% of the city's population. "Come to the mosque, and you will find Pakistanis, Bangladeshis, Africans, all together," says Mr Khan. Nor has the fighting between Muslim and Sikh or Hindu youths that has hit other towns bothered Bradford. It is also the only city whose mosques—40-odd, in all—work under one umbrella organisation, the Bradford Council of Mosques.

Mr Khan frets, however, that the relative peace is uneasy. This is the city, after all, where copies of Salman Rushdie's "Satanic Verses" were burnt in 1989, and where Muslim youths rioted in 1995 and 2001. The first riots were caused by heavy-handed police, the second by attacks from white youths, but both had roots in poverty, and marked the rise of a Muslim generation with a new attitude.

Unlike their immigrant parents, who tended to turn the other cheek when faced with an affront, these British-born Muslims are assertive about their rights and their religion. Yunas Samad, a sociologist at the University of Bradford, says that poverty and unemployment among Muslims in northern former textile towns have made Islam an important badge of identity to young people. "It is not greater religiosity," he says, "It is that in British secular society, religion becomes one way of defining themselves as different."

In this context, the attitude of British Muslims to war in Iraq may be a cause for concern if and when war starts. Bradford's youths do not think that the issue is Saddam Hussein's arsenal. Among a group of students coming out from lunchtime prayers at the University of Bradford, Ezazul Islam says that if it was about Saddam Hussein, he could be removed by the SAS. Seizing control of Iraq's oil reserves is a part of British and American strategy, the students think. But, says Abdul Hamid, "millions of Muslims will be killed." He argues that Tony Blair is dangerous because he is a committed Christian who has read the Koran and knows that Islam will eventually dominate the world. "He is trying to prevent that by taking control of Iraq, then it will be Iran, Syria, Saudi Arabia. He is targeting these countries," he says. The others nod.

These young men say that they oppose the terrorism of Hamas and al-Qaeda, but they also see war in Iraq as a recruiting sergeant for such causes, much as the behaviour of British troops strengthened the IRA in Northern Ireland in the 1970s. "The next generation will be much worse," says Mr Hamid. They

may also be British.

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Show business

Benn and the butcher

Feb 6th 2003
From The Economist print edition

An old political lag finds a new career

AP

Two old showmen get together

AT A time when it is harder and harder to sell reality TV shows and costume dramas around the world, ever-inventive British television executives have come up with a brilliant new format: put together a Middle Eastern dictator on the brink of war and an old British leftie, with not much more than an Iraqi flag, a copy of the Koran and a box of tissues as props—and bang, worldwide sales are assured.

Not only was Tony Benn's interview with Saddam Hussein, broadcast on February 4th, a brilliant coup for Channel 4, it was also a model for the many viewers who complain about the inquisitorial style of television interviews. Did Mr Hussein have weapons of mass destruction? No, he did not. Mr Benn nodded sympathetically. Did Mr Hussein have any links with al-Qaeda? Certainly not. Mr Benn nodded understandingly. Why was Mr Hussein having difficulties with the UN weapons inspectors? Life's a difficult business. Mr Benn nodded consolingly.

But perhaps it is not surprising that Mr Benn and Mr Hussein hit it off so well. They have something in common: being widely loathed. Mr Benn, a former minister whose views placed him somewhere over the edge of the far left wing of the Labour Party, was once the most reviled politician in Britain. Thanks to his constituency Jacobins, Labour's manifesto in 1983 called for large-scale nationalisation, punitive taxation, more power to the trade unions, unilateral nuclear disarmament and withdrawal from the European Economic Community. Labour's then shadow home secretary, Gerald Kaufman, dubbed it the longest suicide note in history.

These days, Mr Benn is regarded as a bit of a card and a charming reminder of bygone days when politicians had convictions. His stage show, in which he puffs on his pipe and chats about politics, has been an unexpected hit. Perhaps Mr Hussein can look forward to a similar future, reminiscing on television chat shows about how he hid all those weapons of mass destruction and then couldn't remember where he put them.

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Constitutional reform

Lordy, lordy

Feb 6th 2003
From The Economist print edition

How messy can it get?

JUST before votes this week to decide how to reform the House of Lords, the leader of the House of Commons, Robin Cook, declared that the efforts to modernise the second chamber had become the parliamentary equivalent of “Waiting for Godot”: “It never arrives and some have become rather doubtful whether it even exists, but we sit around talking about it year after year.” How right Mr Cook turned out to be.

Given a free vote and the choice of seven different options, ranging from a wholly elected body to one that would be entirely appointed (with various hybrids in between) MPs succeeded in knocking down each and every one. Although it is clear that most MPs want a large elected component in the second chamber—the election-free zone the prime minister favours lost by 78 votes—that now counts for little, especially as the Lords themselves, egged on by the Lord Chancellor, are determined not to have democracy imposed on them.

It will now be for a joint committee of both houses of parliament to try and plot a way forward. “Heaven help them,” said a bitterly disappointed Mr Cook. What is certain is that the government, in the shape of Tony Blair, won't. This is one play that will run and run.

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Housing

Brave new homes

Feb 6th 2003
From The Economist print edition

The government wants more concrete in the south-east. It may not get it

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IT USED to be so much simpler: when governments decided more houses were needed, they planned and built them. But this week, John Prescott, the deputy prime minister, announced instead a programme to create “sustainable communities”, so bagging two of the most favoured words in New Labour's lexicon in one catchy phrase.

It is political nervousness that condemned what is essentially a big house-building programme to such a polysyllabic euphemism of a name. The government is determined to build many more homes in London and the south-east, even though the region is already congested and densely populated, but fears opposition.

Two years ago, the government decided that local authorities in London and the south-east should allow an extra 62,000 new homes to be built every year—in all, 930,000 until 2016. Now it wants to raise that target to 75,000 a year, adding an additional 200,000 new homes by the middle of the next decade.

The extra 200,000 houses will be concentrated in four “growth areas” around London (see map). About half of them are expected to be built in the area the government calls the “Thames Gateway”, to the east of the capital. The government is planning to spend nearly half a billion pounds to redevelop this blighted wasteland. The beauty of the area—for Mr Prescott at least—is that little of the land will be greenfield. This will help him reach his national target of building 60% of the new homes on brownfield sites (ones that have already been messed up by previous development), so allowing himself to brandish his environmentalist credentials.

But looking further ahead, many more houses could be built in the two growth areas to the north of London. Studies by consultants suggest that the area around Milton Keynes and Northampton could accommodate 370,000 homes by 2031. The consultants say that the area from London through Stansted to Cambridge could accommodate up to 500,000 new homes over the next three decades.

The government's rationale for stepping up housebuilding is clear. Ministers fear that housing shortages in London and the south-east will hold back growth. They want to ensure that labour is available for businesses wishing to locate in the most dynamic part of the national economy.

But it may prove hard to get these houses built. Brownfield sites are often costly to clean up. Sir Peter Hall, professor of planning at University College, London, says “the brownfield policy has proved to be a disaster because it is not delivering the land needed.” Anyway, brownfield sites are often in areas where nobody much wants to live. If the Thames Gateway plan is really to work, it will require big, expensive investments in transport infrastructure, such as Crossrail, a scheme for an east-west railway across London which has been talked of for 20 years.

In the more desirable areas of the south-east, councils have ignored previous government diktats. House-building is now running well below levels envisaged in previous plans. The government will find that publishing glossy brochures with fancy titles is a great deal easier than defeating rich nimbies.

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Company pension funds

Counting the damage

Feb 6th 2003
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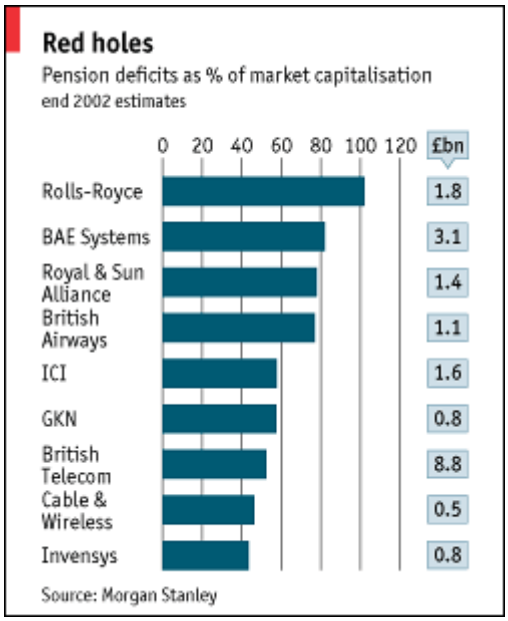
The companies with the biggest holes in their pension funds

THE worst bear market in a generation has savaged pension funds, ripping a hole in their assets. The total gap between pension obligations and assets in the defined-benefit schemes of Britain's top 100 companies has risen to £85 billion. A year ago, the aggregate deficit was negligible, now it amounts to a tenth of the total value of the FTSE 100 index.

That is worrying enough in itself, but several companies are facing even bigger deficits in relation to their market value. At the end of last year, nine firms had pension-fund deficits worth more than 40% of their market capitalisation, estimate analysts at Morgan Stanley, an investment bank. The companies include some of the proudest names of British industry: Rolls-Royce, the aero-engine manufacturer, BAE Systems, the defence manufacturer, British Airways and British Telecom. They also include Cable & Wireless, a telecoms firm recently thrown out of the FTSE 100; Morgan Stanley based its analysis on companies in the top 100 list last August.



How have so many big firms managed to get their pension funds into such a pickle? Typically, they are older industrial groups with mature pension schemes, so that the number of pensioners is high compared with the number of workers. As a result, the pension funds are worth more than the companies themselves. The funds have also been heavily exposed to equities, so they have been hit hard by plunging stockmarkets. For example, Rolls-Royce had two-thirds of its pension-fund assets in stocks at the end of 2001. These equities in the pension scheme were then worth 16% more than the company itself.

Adding to their woes, the worst affected pension funds have also been caught in a double squeeze affecting all company schemes. Not only have assets dropped in value, liabilities have also risen. This is partly because of rising life expectancy among pensioners. It is also because corporate bond yields—used to discount future pension obligations into a present value—have been falling; and the lower the discount rate, the higher the present value of the pension liabilities. Normally falling bond yields lead to rising equity prices as investors place a higher value on future earnings, but this effect has been conspicuous by its absence in the current bear market.

Morgan Stanley's calculations are based on the new FRS 17 accounting standard for valuing pension funds. This does away with actuarial jiggery-pokery in estimating liabilities and so exposes the true volatility of pension funds with a high weighting of their assets in equities. The full implementation of FRS 17 has been postponed to 2005, partly to give companies a breathing space. When it does come into force, firms will have to include the full pension-fund position on their balance-sheet, which will generally reduce their net worth.

Britain's pension-fund shortfalls will be a drain on future profitability. Companies will have to increase their contributions which will lower their earnings. Under current accounting rules most companies do not report the full costs of pension provision in their profit and loss account. For example, this year's expected post-tax profits of Invensys, an engineering group, would be cut by 39% under the FRS 17 standard, estimates Morgan Stanley.

As finance directors stare into the red holes that so many pension funds have become, more schemes will be closed to new members. Even a sharp recovery in the stockmarket is unlikely to help that much. The bear market has made many companies determined to limit their exposure to risky pension-fund obligations.

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Olympic economics

Chasing gold

Feb 6th 2003
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Taxpayers would have to subsidise the Olympics, but it might still be worth it

Reuters

Anyone know the way to London?

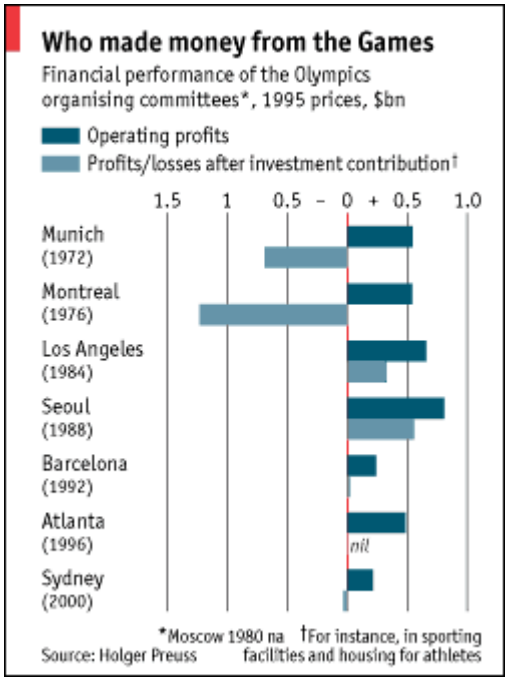
OVER 80% of Britons want it, and Ken Livingstone, the mayor of London, is pushing for it. The government, initially reluctant, seems to be coming round to the idea of supporting a bid for London to host the Olympic games in 2012.

Promises of prestige, a tourism boom and urban regeneration are counterbalanced by worries over money. Putting a bid together is likely to cost £13m alone. And estimates of the cost of staging the Olympics are fuzzy: Arup, a consulting firm, estimates it at £1.8 billion, with a deficit of £494m; but according to Tessa Jowell, the culture, media and sport secretary, total costs are likely to be £4.5 billion, £2.6 billion of which would have to be covered by public money. With Britain's dismal track record over large projects such as the Dome, this is enough to make the government nervous.

So how have the economics of the Olympics stacked up in the past? According to Holger Preuss, professor of sports economy and management in Cologne, all games over the past 30 years have turned an operational profit (see chart), unlike most other sporting events. This is largely thanks to broadcasting and sponsorship, which typically covers 40-60% of the local Olympics organising committees' budgets. Broadcasting rights for the 2004 games in Athens have been sold for $1.5 billion, over ten times more than in 1980: in 1948, when broadcasting rights were first introduced, the organising committee did not cash the 1,000 guineas charged to the BBC, out of concern that it might cause financial hardship. Further revenues come from licensing, ticketing and local marketing. In 2000, the Sydney organising committee's revenues totalled A$2.8 billion ($1.6 billion).

It is investment, not operating costs, that cause the problems. Depending on what is already available, hosts may have to build new sports facilities and Olympic villages, expand airports, roads and public transport, and, in some cases, give their city centre a

facelift. The hangover after the 17 days of Olympic glory can be unpleasant. Montreal, which made a profit on operations in 1976 but had to borrow heavily to cover investment in new facilities, is still repaying its Olympic debts today.



Following this financial disaster, no one but Los Angeles offered to host the 1984 games, and the economics of the Olympics then took a different turn. Out went the white elephants and construction showcases funded by public money, in came more private funds, temporary facilities and a more efficient use of existing infrastructure. It worked well for Los Angeles, which was already lavishly equipped and remained faithful to the approach it adopted for the 1932 games, then described as “typically exuberant and money-oriented”. For the first time for years, the Olympics organising committee actually made an overall profit (20% of which went back to the IOC and the rest to promote sport at home). In Atlanta, however, this all-private approach resulted in what was perceived as an over-commercialisation of the games and poor co-ordination with public bodies.

Most hosts adopt a more balanced approach: in Sydney, two thirds of the A$3 billion capital investment bill was financed by public funds, the rest being private money. The organising committee contributed only 12% of the total, which allowed its books to more or less balance but left New South Wales taxpayers to pick up a A$1.3 billion tab.

So what about London? The mayor has said the Greater London Authority would foot part of the £2.6 billion bill through a council tax surcharge. The remaining £1.5 billion could come from a special lottery fund. But broader economic benefits are expected to offset part of the financial sacrifice. In Sydney, the games are reckoned to have generated A$3 billion in new business and over A$6 billion in tourism revenues. The cabinet is expected to make a decision on the London bid next week. Competition is likely to include New York, Paris and Moscow, but if a British bid adds to the list, Londoners will have to hold their breath until 2005, when the IOC will make its decision.

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Bagehot

Gordon Brown, tragic hero

Feb 6th 2003
From The Economist print edition

The chancellor's potential for greatness is undermined by a fatal flaw

SPEAKING this week at the Social Market Foundation, a centrist think-tank, Gordon Brown was as formidable as only he can be. In just over an hour he rattled through an 11,000 word lecture (no other word describes it) on the role and limits of markets in public services. Dauntingly serious of purpose and relentless in delivery, without a pause or an aside, let alone anything resembling a joke, Mr Brown sought not to persuade but to bludgeon his audience into submission. When he got to the end, many who staggered to their feet had the glazed looks of those who have taken one blow to the head too many. As a performance, it was magnificent, and also slightly appalling.

Mr Brown is the most compelling figure in government. He has none of Tony Blair's charm. But a certainty that he is right, combined with the belief that anyone who thinks differently is intellectually and morally deficient, gives him strength in a government that often seems not to know what it believes in. His suspicion of colleagues has kept him short of friends, but his determination to bend others to his will and his unconcealed contempt for political opponents (a broad church for Mr Brown) have made him a literally awe-inspiring figure.

But Mr Brown's ability to terrorise has of late receded. Both Alan Milburn, the health secretary, and Charles Clarke, the education secretary, have recently won at least partial victories against him. The cleverer Tories, having failed to lay a glove on him during his first five years in office, think that he has become vulnerable. As one shadow cabinet member has put it: “Gordon was this government's rock; now he's its biggest liability.”

Mostly this is because the economy has at last turned against him. Although Mr Brown can claim with some justification that Britain is better placed than many countries to ride out current economic storms, anxiety is growing and with it the idea that the chancellor may be making things worse. On the main issue that determines the fate of governments—economic competence—according to the latest *Daily Telegraph*/YouGov poll, Labour is level-pegging with the Conservatives for only the second time in a decade.

The labour market is still strongish, thanks mainly to the expanding public sector, and interest rates have remained stable. Few economists expect a repeat of the recessions that marked the beginning of the last two decades. The rout in the City, with its knock-on effect on pensions and life policies, allied with nervousness about house prices, may well have fuelled a new mood of pessimism and uncertainty. But, while many recall Mr Brown's early and ill-advised raid on the pension funds, few would blame him directly for stockmarket falls that are not far out of line with other countries.

Where the chancellor cannot escape blame so easily is the very rapid deterioration of the government's own finances. Mr Brown's decision to pour unprecedented sums into a largely unreformed public sector looks increasingly reckless. Already, the health service appears incapable of absorbing even a fraction of the sums being thrown at it. As people begin to realise that the tax rises needed to fund the spending splurge are unlikely to be limited to April's rise in national insurance contributions, it is not surprising that the chancellor's stock is in decline.

Which leads straight back to Mr Brown's big speech on what markets can and can't do. Mr Brown thinks that while markets may be very good at signalling preferences and allocating resources for most consumer goods (as long as vigilant governments act to remove barriers to fair competition), they fail when you apply them to things like health care and education. Yet his cherished private finance initiative (PFI) is exempt from this rule. The private sector, in his view, has a role to play in supplying infrastructure and ancillary services to schools and hospitals, but it must be kept well away from core

provision.

The chancellor deserves some credit for addressing these difficult issues. But his exposition of the subject threw more light on him than it did on the role of the private sector in public services.

A question of trust

Mr Brown does not believe that “consumers” (patients, in old-speak) should have too much say in their own health care. Their lack of information, he contends, renders them incapable of negotiating the best product at the best prices with hospitals that are also akin to local monopolies. He is wrong. Quite apart from the fact that patients are increasingly knowledgeable, the real consumers would be doctors, acting as intermediaries on behalf of patients, choosing between providers competing on cost and quality. Mr Brown's claim that this wouldn't work because no local hospital could be allowed to go bust is equally specious. When companies fail, their assets and staff rarely disappear: they are usually taken over and given new managements.

Mr Brown has no problem, by contrast, with PFI, even though, as many critics have pointed out, most infrastructure projects could be funded more cheaply by government if the Treasury was willing to have them on its books. So why does PFI recommend itself to Mr Brown? Not so much as a spur to competition or as a way to extend choice, but as a nifty accounting wheeze for taking capital investment off the government's books and bringing in private sector cash.

The flaw that runs through the chancellor's thinking is this: he does not trust anyone other than himself. He does not believe in giving ordinary people market power because he does not trust them to make informed decisions about what is best for them; nor does he trust those responsible for delivering services to respond rationally to normal incentives. It is lack of trust that drives Mr Brown's passion for targets. And it is also lack of trust that poisons too many of his relationships with colleagues, from Tony Blair downwards. It is very sad.

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The weakest link

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From The Economist print edition

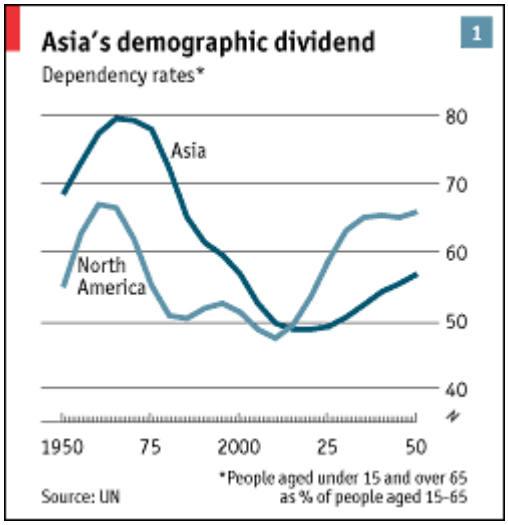
Asia is now recovering from its financial crisis five years ago, but with bad debts of $2 trillion, it is still crying out for financial reform, says Dominic Ziegler

EAST ASIA'S financial crisis of 1997-98 is gradually being re-evaluated. Many analysts now argue that, however cataclysmic it seemed at the time, it was also the best thing that could have happened to the region. As Nicholas Kristof puts it in “Thunder from the East”, co-written with Sheryl WuDunn, his wife and fellow *New York Times* journalist:

> It entailed a terrible human cost, but it is also helping to destroy much of the cronyism, protectionism and government regulation that had burdened Asian business. The crisis helped launch a political, social and economic revolution that is still incomplete but that ultimately will reshape Asia as greatly as the fall of the Berlin wall reshaped Europe.

Mr Kristof, indeed, thinks that this revolution is going to wrench economic, diplomatic and military power from an American-led West.

The belief that the crisis was a good thing for Asia is now taking hold at the region's brokerage houses and investment banks. They clearly have an interest in spreading the message, but it is not without substance. After all, the demographics that underpinned so much of the Asia-Pacific region's economic success for the past three decades or so still have some way to run. Since 1965, the ratio of the region's dependants—those 15 and under or 65 and over—to its working-age population has fallen from 80% (including lots of kids) to 55%. For the region as a whole it will reach its lowest point around 2015, at 49%. Yet in many of its constituent countries the ratio will be very much lower. By contrast, in the West the ratio is set to rise fast as the population ages (see chart 1).



This is what people mean by Asia's demographic dividend. Christopher Wood, equity strategist at CLSA Emerging Markets, compares the swelling cohort of working-age Asians (including India but excluding developed Japan) with America's post-war generation of baby-boomers. As that generation passed like a large animal through the digestive tract of the American economy (Mr Wood's herpetological metaphor), its numbers and sheer exuberance did much to drive America's consumption patterns and even its equity markets—at least until the bust at the

end of the 1990s. Mr Wood predicts a similar effect on consumption and regional share prices from Asia's new baby-boomers.

There is nothing far-fetched about this. MasterCard's chief Asian economist, Yuwa Hedrick-Wong, says that, as a general rule, when an Asian's income passes $5,000 a year before tax, he has money in his pocket to burn. Very roughly, for every extra dollar earned over the $5,000 income threshold, 60 cents go on discretionary spending. How many discretionary spenders does that make? About 225m Asians outside Japan, Mr Wood reckons, using figures for GDP per head and adjusting them for the distribution of income.

Now for a bit of idle speculation. If Asia's annual average growth in per-head income between 2000 and 2020 were to equal the rate between 1980 and 2000 (that is, including the period of financial turmoil, when GDP in the crisis-hit economies plummeted), then the number of high spenders would rise to 340m in 2010 and 682m in 2020. But if income grew at the average rate in the ten years immediately before the crisis, the number would rise to 541m and 1.1 billion respectively.

A billion boomers

Nor is that all. CLSA's regional economist, Jim Walker, has long argued persuasively that Asia's unofficial or black-market economy is as much as half the size of the official economy—and that it is a better engine of consumption because it is not taxed at source. After allowing for the black economy, the number of discretionary consumers in 2020 may have risen to as much as 1.4 billion. “Asia's billion boomers”, as CLSA puts it, no longer seems outlandish. It could lead to a virtuous circle as the high savings which hitherto have fuelled much of Asia's export-driven growth are drawn into domestic consumption. That, in turn, would encourage a more balanced regional development, less dependent upon exports and, above all, upon the increasingly unreliable-looking health of the American economy.

Not outlandish, and certainly desirable. Yet this survey will argue that post-crisis Asia is still very far from realising its economic potential; and that rickety and hugely inefficient financial systems remain the biggest economic constraint. The radical transformation of the region's financial systems needed to underwrite optimistic assumptions about future growth has, by and large, yet to take place.

Certainly, an economic recovery in the region has begun. In 2002, East Asian growth probably averaged nearly 5%, after 7% and 3% respectively in 2000 and 2001—a little wobbly, perhaps, but a vast improvement on the late 1990s. However, as Joan Zheng at J.P. Morgan Chase in Hong Kong points out, in dollar terms only two economies, China's and Hong Kong's, are now at higher levels than before the financial crisis—and these two economies were not directly hit by it. China escaped because its currency is only partially convertible (which meant that its technically insolvent banking system was not exposed), Hong Kong because of its first-world banking system and abundant foreign-exchange reserves. As for the rest of the region, most economies have not even clawed their way back to pre-crisis levels once steep falls in their exchange rates are taken into account.

For much of the region, the crisis destroyed wealth on a massive scale and sent absolute poverty shooting up. In the banking system alone, corporate loans equivalent to around half of one year's GDP went bad—a destruction of savings on a scale more usually associated with a full-scale war. In a number of countries, governments have helped to take these loans off banks' books, in the hope of cleaning up the banking system and encouraging banks to start lending again. Yet, notably in Indonesia and Thailand, they have often dithered over dealing with the bad loans and with the companies responsible for them—even though they know that putting off the problem ensures that the eventual cost will be very much higher.

Meanwhile, several economies are turning a blind eye towards banks that continue to lend to the politically well-connected, or that tolerate companies not keeping up with repayments, a nod-and-a-wink known in the trade as forbearance. Such practices prevent capital being allocated in the most efficient way. They stop the region from drawing a line under the past and looking to the future.

To be fair, in some quarters the lessons of the crisis have been swiftly learnt. South Korea—a country that by the mid-1990s appeared to have graduated permanently to the ranks of the developed world, only to find itself on the brink of bankruptcy in late 1997—is the clearest example of how quickly reforms can produce results if the initiative is seized. The government took many bad loans away from the banks and sold them to all comers, even foreigners, if necessary at knock-down prices. It drastically slimmed down the banking sector (again inviting in foreigners) and liquidated some of the most heavily indebted

and least profitable Korean companies. As a result, the Korean economy has been transformed. Not only are today's export-oriented conglomerates, the *chaebol*, in far better health, but new sources of growth, notably domestic demand and consumer credit, have appeared, and foreign direct investment (FDI) has soared. Since the crisis, over 1m new jobs have been created, and the country appears to be climbing back towards a growth rate of 5-7% a year.

Some South Koreans compare the magnitude of the economic shock of 1997-98 to the Korean war. Women lined up to donate their wedding rings to saving the country's finances. It took a national crisis for South Korea to turn from an inward-looking nation to one that embraced foreign capital, change and competition. The country's economic transformation required radical political change, led by Kim Dae-jung, once an imprisoned dissident. Whatever the later mis-steps in Mr Kim's presidency, in his early days he helped to make Koreans face up to their economy's shortcomings. Still, South Korea is the exception, and questions remain even there—particularly about the continued high indebtedness of many companies, and about the adequacy of the banks' experience in dishing out credit to consumers.

An incomplete revolution

In Indonesia, the crisis fostered a political revolution that unseated the long-standing dictator, Suharto, and ushered in democracy. Since then, no profound economic revolution has followed the political one. Instead, reforms have been introduced incrementally, amid much muddle and corruption, and have often appeared to make little progress.

The government, having taken over most of the banking sector's non-performing loans, now controls great swathes of the Indonesian economy, from telecoms to plantations, and has nationalised nearly all the banks as well. Yet it has done far too little to get these assets swiftly off its books. As a result, foreign investment continues to leave the country, Indonesian Chinese businessmen keep their flight capital in Switzerland or Singapore, banks refuse to lend money to those that have a use for it, and the fiscal situation, though better than it was, still looks difficult. “This is a country that was never ready for reform, but was asked to undertake multiple reforms at once,” says a senior Indonesian banker. Without political will and a national consensus, as in South Korea, that was bound to cause trouble.

Not all the time in the world

Progress in financial reform matters, not least because the demographic window of a growing working-age population will not be open for long. It is not necessarily a bad thing for Asia's traditionally high savings rates to fall as consumption rises, but it does mean that savings will need to be allocated far more efficiently than in the past—at a time when rapidly ageing populations will be putting fresh demands upon financial resources. Smaller households and more working women mean that the traditional, extended Asian family, where the old move in with their children and expect to be cared for, is on its way out. Increasingly, people want to push the costs of caring for the elderly on to the state. For instance, by 2025, China's population, now 1.3 billion, will have risen to 1.5 billion, and will contain the same proportion of elderly people (one-fifth of the total) as the OECD economies have today. But whereas North America and Europe have had the best part of a century to organise their pension systems (and have yet to resolve huge problems), China has only a quarter of that time to get ready. As it is, the state faces a $100 billion-200 billion unfunded pension liability for its urban residents alone. What will happen when countryside folk dare to demand equal treatment?

The challenge, then, is to develop regional banking and capital markets that are efficient, deep and well-regulated, so that savings can be channelled to where they get the highest returns. Today, Asia's financial sectors are fragmented, parochial, illiquid and poorly policed; they misprice capital. In addition, capital markets are under-represented, because banks are unhealthily dominant. Although Asia (including Japan) accounts for over half of mankind, one-third of the world's GDP and one-quarter of its exports, the region's share of worldwide equity-market capitalisation is only 16%—or merely 5% without developed Japan. To the optimists at Asia's investment banks, that is just one more reason to forecast a secular bull market in Asian equities, as we shall see later. But it is also a measure of how much emerging Asia still has to do in the financial area.

Defining Asia is the stuff of many debates. Lumping together a region where annual income per head ranges from $280 (Laos) to $31,000 (Japan) is bound to be problematic. For the rest of this survey, Asia generally means East and South-East Asia, and in particular the economies of South Korea, the Philippines, Indonesia, Thailand and Malaysia that were hit hard by the crisis of 1997-98.

There is no need to worry too much about Singapore and Hong Kong. True, Singapore is finding itself in the wrong place at the wrong time, surrounded by struggling economies when its own specialities, high technology and electronics, are also being knocked by a slump in American demand; and Hong Kong is agonising loudly about its role in the Chinese economy. Yet the prosperity of the two city-states is pretty much secure, however much they like to fret about financial competition—from each other, or even Shanghai. By the same token, both offer useful examples for their poorer neighbours about how to develop financial markets, and how to think about their future challenges, even if they sometimes fall short in political imagination or public participation.

Japan, so overwhelmingly the region's biggest economy, enters this survey's calculations when it has lessons to teach the rest of Asia. Regrettably, the biggest lesson is the baneful effect on economic growth of not tackling bad debts in the banking system. The consulting arm of Ernst & Young estimates that Asia has $2 trillion of non-performing loans, of which $1.2 trillion reside in Japan—and that is over a decade after the country's asset bubble burst. What is more, the aggregate figure has not shrunk even though banks have got rid of around $300 billion of bad loans since 1997, so fast are other loans souring. The prime minister, Junichiro Koizumi, has now launched a last-ditch attempt to sort out the banks. It will fail, unless the country's deflation is cured at the same time.

Japan's domestic shortcomings also affect the region more directly, in that for most of the past decade, and particularly since 1997, stricken Japanese banks have withdrawn from the region, and their absence is now almost complete. Asians, in other words, have had to rebuild their financial systems without any private-sector help from their richest neighbour, at a time when foreign private investment is crucial for their transformation.

India, though a huge country, is not covered by this survey, partly because the line has to be drawn somewhere, and partly because it is still an inward-looking economy that attracts relatively little foreign investment, was scarcely affected by the regional crisis of 1997-98 and plays a very much smaller role in world trade today than it once did. For instance, despite its importance in software programming, India has no part in the production chains that are an increasingly striking aspect of regional trade patterns in East Asia. Cambodia, Laos, Myanmar, Vietnam and benighted North Korea, because of their isolation and socialist backwardness, are regrettably also left out of the calculations.

The giant stirs

China, by contrast, plays a large and growing part in world trade and now accounts for nearly 5% of world exports, seven times as much as India. It is by far the biggest link in the East Asian production chain. China is the dominant recipient of foreign direct investment ($55 billion in 2002) going to developing countries, and last year may have surpassed even America as the world's biggest recipient. Its $600 billion of non-performing loans equal those of the rest of emerging Asia put together. The success or otherwise of China's financial reforms will have a bearing on the whole region. Although the country did not itself suffer a crisis in those dark days of 1997-98, it first acknowledged the huge shortcomings in its own financial system when it saw its neighbours' systems laid bare. It is emphatically included in this survey.

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Rocky shores

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Lessons in dealing with duff loans

FIVE years after the Asian financial crisis, people are still arguing about what exactly went wrong, and how it should have been put right. But most can agree on the background conditions that led up to the debacle. For many years the countries concerned had been pursuing a growth strategy centred on the exports of manufactures, following the then highly successful Japanese example. Financial resources were marshalled by keeping a lid on domestic consumption, and by encouraging the financial sector to channel savings to exporters. In return, governments shielded the financial sector from competition, along with other domestic services and natural resources.

During the early 1990s, exports boomed, and both foreign direct investment and portfolio money poured in as financial markets were liberalised. Companies assumed ever higher levels of debt, notably in the form of short-term foreign-currency borrowings, while a rush of foreign money fed stockmarket and property booms. Current-account deficits ballooned as national currencies tied to the dollar continued to give the impression of immutably fixed exchange rates.

Yet from the mid-1990s export growth softened and money, both foreign and domestic, started to leave these hot economies. On July 2nd 1997, Thailand's government, after futile attempts to stop the capital flight by raising interest rates and selling dollar reserves, allowed the baht to sink. Over the next few months other countries followed. At the height of the panic the Indonesian rupiah lost over four-fifths of its value, rendering the entire banking system insolvent. The panic spread beyond the region, to Russia and Brazil, and to American hedge funds. In Asia itself, financial mayhem led to political chaos.

Five years on, a degree of calm has settled upon the region, though the political tremors still reverberate. Indonesia is on its fourth leader in five years. And in the Philippines a corrupt president was, with questionable constitutionality, jettisoned in mid-term, to be replaced by his vice-president who now says she has too insecure a mandate to run in elections in 2004. On the other hand, in Thailand the crisis engendered a new constitution and stronger, more stable government.

Macroeconomically, the crisis countries are in a far sounder state. External finances have been restored to health, thanks to balance-of-payments surpluses on the back of renewed exports and much-reduced domestic demand. The short-term foreign-currency borrowings that were the catalyst for the whole mess have largely been rescheduled or paid off. Governments have rebuilt robust—perhaps unnecessarily robust—levels of reserves, and are paying back the multilateral and bilateral loans that bailed them out during the crisis. Currencies are no longer volatile, and interest rates and inflation in most of the region are low.

Marking the miracle to market

Yet despite these external strengths, Asia has a vast and unresolved legacy to deal with: the region's non-performing loans (NPLs), exposed as the crisis receded. The extent of these loans can be seen as a

ready-reckoner of the cost of Asia's old, unbalanced economic model, a kind of marking-to-market of the whole region.

A proper accounting for the cost has yet to take place, for a big proportion of these bad loans has still not been disposed of. And for as long as an overhang of NPLs persists, the companies responsible for them will put off the needed restructuring. They are sometimes called the region's zombie companies, kept alive by unnaturally low interest rates, or by overdue interest payments being rolled over into the loan's principal.

Accurate estimates of the NPLs are hard to come by. Ernst & Young calculates its total figure for the region of $800 billion, or $2 trillion including Japan, by applying best international practice to the assessment of loans. One reason why the figures are hard to pin down is that Asia is still on the way to adopting uniform standards for assessing delinquent loans. Official figures invariably understate the problem, sometimes by a huge margin (see chart 3).

Whatever their exact size, the NPLs represent a misallocation of resources on a giant scale. And the greater the delay in tackling the zombie companies—by breaking up and selling off corporate bits with any value, putting seized collateral (usually property) on the market, and liquidating companies that are not worth anything—the longer the region will take to make a full economic recovery.

Many of these loans, admittedly, have been shifted away from the banks that made them in the first place. All the crisis economies except the Philippines have set up some sort of government-sponsored body, usually called an asset-management company (AMC), to take distressed loans off banks' books. Philippine banks actually have a higher proportion of dud loans on their books now (19% of all loans) than during the worst of the financial crisis (15%), but elsewhere the burden of bad loans has been passed, at least in part, from the financial sector to the public. Still, the record is mixed.

The Korean Asset Management Corporation (KAMCO) has been so successful that it now advises other countries, from Russia and China to Indonesia, on tackling bad debts. Choi Beom, an executive director, says that some of his 1,250 colleagues favour eventual privatisation: KAMCO's right to use fresh public funds to buy non-performing loans ran out last November, and its public remit expires in 2005.

Immediately after the crisis, KAMCO took on the task of buying from banks (at a discount to face value of around 60%) some $58 billion of bad loans, equivalent to nearly four-fifths of banks' total loans, or 30% of GDP. Since late 1998 it has sold over 70% of these loans, and the debt of a single giant borrower, Daewoo, which was rescued in 2000, accounts for a large proportion of the remainder.

The Korean authorities accepted early on that governments make poor asset managers, and that the more quickly distressed assets are disposed of, the lower the cost to the taxpayer. KAMCO took an innovative approach. For advice, it sought out former regulators from the Resolution Trust Corporation, charged in the 1980s with cleaning up America's savings-and-loan (thrift) crisis, and from Securitas, which handled Sweden's banking crisis in the early 1990s. It brought in western investment banks who know how to bundle up and securitise property assets for sale. It sold some distressed assets in bulk, by auction or tender, and others to American buy-out funds run by companies such as GE Capital, Lone Star, Goldman Sachs and Morgan Stanley. Several of these had learnt specialist skills in so-called loan workouts during the savings-and-loan crisis and, later, when leveraged buy-outs were all the rage in America. Sometimes KAMCO formed joint ventures with such firms, profiting from any value created. KAMCO's efforts, in turn, have helped establish a secondary market in distressed debt, with a face value of $22 billion, which makes it easier for banks to offload bad loans still on their books.

In September 1998 Malaysia drew widespread criticism overseas for slapping on currency controls in response to the crisis, which the prime minster, Mahathir Mohamad, blamed on a western conspiracy. That did not help Malaysia's case; nor, later, did the curious arrest and imprisonment of Dr Mahathir's finance minister. Still, Malaysia used the relative calm created by the controls to get to work on problem

loans.

For a start, it set up a restructuring body to deal with the biggest corporate debtors. This was wound down last year, having finished its business. Meanwhile, the national asset-management company, Danaharta, has done a good job helping to clean up the banks' non-performing loans. Danaharta has been lucky in avoiding the moral hazard (or worse) to which AMCs in some other Asian countries are exposed by their conflicting duties, to the taxpayer, to banks that need recapitalising and to companies that the government wants to keep afloat. Danaharta's job is simply to resolve non-performing loans at the lowest cost to the taxpayer consistent with lightening the banks' NPL burdens enough to get them lending again. It is under no pressure to buy loans from banks which, in turn, are under no pressure to sell.

Instead, independent valuers estimate what the loans that banks want to offload are worth. If the loans look viable, Danaharta restructures or reschedules the debt; if they do not, the collateral is sold and the business liquidated, or a special administrator is appointed to sell the business by tender. As payment for NPLs, the offloading banks get zero-coupon bonds issued by Danaharta. If the recovery value for an NPL is higher than Danaharta's cost of acquisition, the selling bank gets four-fifths of the difference—an incentive for banks to offload such loans. Danaharta says that it acquired half of its portfolio of non-performing loans for an average of 46% of their face value; the other half were bad loans already owned by the government, and given to Danaharta to sort out. It expects an overall average loan-recovery rate of 57% before it winds itself down in 2005, turning a small loss overall. In all, though, the government expects the bank clean-up to have cost a mere 5% of GDP, far less than many other countries are having to spend.

However, a spanner has recently been thrown in the works. The most effective national asset-management companies everywhere have powers to bypass the courts when foreclosing on property assets, the most common form of loan collateral in Asia. Yet in December a local court ruled that Danaharta's special exemption from legal challenges to its restructuring plans was unconstitutional. Danaharta is appealing against the ruling.

Muddle and drift

KAMCO and Danaharta were fortunate in being handed clear and powerful mandates, which some other asset-management companies lack. In Thailand, for instance, the Thai Asset Management Corporation (TAMC), set up only in 2001 and controlling some two-fifths of all the distressed loans in the financial system, is charged not with minimising the claims on taxpayers but, in the words of an international adviser, “with helping debtors stay in the game”. It is attempting to restructure the assets on its books rather than to sell them off quickly, partly for fear of being seen to be selling assets to foreigners at knockdown prices. It is a strategy that will turn out expensive for the taxpayer.

Moreover, the TAMC acquired only a minority of private debts—those with many creditors. The bulk of its assets, on the other hand, are all the bad loans from the state banks. At the height of the crisis, 90% of the loans extended by Krung Thai Bank, which has the largest number of branches and employees in the country, were reckoned to be dud. Cleaning up the state banks risks merely setting them up afresh to make yet more politically directed loans, rather than ones based on commercial merits. It simply prolongs the financial system's agony.

Indonesia's asset-management company, the Indonesian Bank Restructuring Agency (IBRA), acquired—at their hideously inflated face value—some $31 billion of distressed assets. As a result, it has come to dominate Indonesia's economic landscape. As well as owning great swathes of industry, it also has a controlling stake in most of Indonesia's banks. Its activities are therefore central to Indonesia's economic recovery.

Yet so far it has sold only one-sixth of the loans it acquired, at 5% of their face value; and in the long run it will be lucky to recover 20% of the face value of all loans. During its short, politicised and often corrupt life, IBRA has had half a dozen chiefs. In 1999 it was implicated in kickbacks from Bank Bali, which dealt the reform process a blow. One former chief, who unwillingly answered the summons to lead the agency, points out that IBRA has an impossible number of stakeholders, including the finance ministry, the central bank, powerful parliamentary committees and an independent review committee.

During the savings-and-loan crisis, America's government spent $80 billion buying dud loans from the thrifts, but got four-fifths of it back. That mattered to congressmen, who had more to lose from angering

voters by wasting taxpayers' money than to gain from helping a friend with an empty shopping mall or office building. In America, it helped that every meeting between the Resolution Trust Corporation and a member of Congress was automatically followed by a press release. In Asia, says a Thai banker, there is no taxpayers' culture, at least not yet; and there are precious few press releases to explain what national asset managers are up to.

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Less is more

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Asia still needs fewer, stronger banks, including plenty of foreign ones

NOT surprisingly, the countries that have been the most energetic in tackling the disposal of banks' bad loans have also gone furthest in restoring banking systems to health. The mere act of setting up a national asset-management company, even if it dithers over what to do with its bad loans, is a step in the right direction.

The most active governments have done much more than that. They have knocked heads together to encourage mergers, used public funds to recapitalise the most promising banks, shut the weakest ones and swiftly privatised those taken into government hands when they posed a systemic threat.

South Korea, again, leads the way. The number of commercial banks there is down to fewer than a dozen, from 33 in 1997. Immediately after the crisis, the government set aside a huge chunk of money, up to 15% of GDP, for cleaning up and restructuring the banking system. Mergers among the stronger banks were encouraged through government purchases of their non-performing loans, and two leading banking groups emerged. A series of mergers among weaker banks was helped along with government recapitalisations which, in effect, nationalised two of them, but both have now been privatised again.

Two other big banks, nationalised in December 1997 because of the systemic risk their losses posed, were cleaned up, recapitalised and had their management changed. One, Korea First Bank, the country's ninth-biggest, was sold in 1999 to Newbridge Capital, an American private-equity group that has been active in post-crisis South Korea, and is thriving. Seoulbank, the tenth-biggest by assets, has been sold to Hana Bank, a larger domestic rival, to form the country's third-biggest group. That union may well set off a fresh round of mergers.

Consolidation has not always gone smoothly. When Housing & Commercial Bank (H&CB), a big mortgage lender, was merging with Kookmin Bank (to form the country's biggest bank, under the Kookmin name), H&CB's boss was held hostage by his employees for two days.

Thailand closed the bulk of the 90-odd finance companies which, because of their short-term foreign-currency borrowings, were a source of so much instability. Only one commercial bank has been closed since, though some have merged. The government plans to privatise the state banks, yet people doubt whether it really wants to give up control of the biggest ones. After all, the prime minister, Thaksin Shinawatra, is committed to stimulating the economy, for which the state banks are an essential tool. In 2002, when private banks scarcely increased their lending, Krung Thai Bank aimed to expand its loan book by 8%, partly by financing government projects and state enterprises and partly by poaching retail customers from private-sector banks.

In Malaysia, the government helped recapitalise the banking system and at the same time raised minimum capital requirements, thus forcing a consolidation in which 54 banks merged into ten broad groups. Zeti Akhtar, the central-bank governor, reckons the groups are now big enough to compete when foreign banks have full access in 2007. The government, she says, will now stand back and let these groups bed down. Eventually three or four full-service banks are expected to emerge, along with perhaps a handful of specialist banks. Malaysian policymakers claim, with satisfaction, that they acted to pre-empt a crisis, not to respond to one—though to most outsiders it did look remarkably like one at the time.

A pre-emptive strike would certainly have been the right thing for Taiwan, which managed to sail through the Asian financial crisis mainly thanks to continuing American demand for Taiwanese information-technology products. It was not until the technology bust a few years later that the shortcomings in Taiwan's own banking system were laid bare. They turned out to be very similar to those elsewhere in the region. Since then the government has got through several finance ministers, but has still not managed to introduce serious reform. Late last year the president, Chen Shui-bian, could not bring himself even to clean up the notoriously loss-making co-operative sector, which lends to farmers and fishermen. Instead of letting the many weaker commercial banks fail, the government expensively props them up. So the banks lose even more money as they write off bad loans, without much prospect that this will reduce their bad-loan ratio.

At the time of the crisis, Indonesia had 238 banks of various kinds, including 160 private banks. Many of these were owned by the big business conglomerates, which milked their captive banks as an easy source of funds. The crisis exposed a tremendous concentration of risk in the banking sector. The government shut down 66 banks and spent tens of billions of dollars providing liquidity support for the system, a good chunk of which bank owners undoubtedly syphoned abroad.

Today the Indonesian Bank Restructuring Agency (IBRA) controls almost all the biggest banks, formerly private ones as well as seven state banks. Although they have been fully recapitalised through the special issue of $50 billion-odd in government bonds, bank consolidation and reprivatisation has been erratic. In 2000 bids for the country's biggest retail bank, Bank Central Asia, were blocked as being too low. Last March the bank was sold to an American private-equity firm, Farallon Capital Management. Next on the block is Bank Mandiri, the country's biggest, to be floated in April, followed by Bank Danamon. If the government is bold, it will sell these at a price to tempt a big foreign bank. Indonesia's banking system would benefit from a strong foreign presence.

When the full extent of the financial crisis became clear, banking experts predicted a great wave of cross-border mergers among Asia's banks, offering a once-in-a-lifetime chance for the world's biggest and most powerful banks—HSBC, Citigroup, Deutsche Bank and the like—to establish a dominant position in Asia. A precedent was not hard to find: following Latin America's banking crisis of 1994-95, foreign banks raised their share of the local banking system from 6% to 22% in Mexico and from 15% to 55% in Argentina.

Foreigners welcome

In Asia, the crisis wiped out the capital of many local banks several times over, and banks struggled to raise fresh capital. New debt and equity issues by banks in the region fell by three-quarters in 1998. Governments that had long kept their banking markets closed to outsiders recognised the desperate need for outside capital. South Korea, Thailand and Indonesia all opened their doors to allow full foreign ownership of local banks; the Philippines and Taiwan raised the limits on majority stakes held by foreigners.

Yet the predicted dominance by international banks has not materialised—and given the meltdown of Argentina's banking system a year ago, perhaps some big banks might no longer want it. Foreign capital has certainly helped transform some countries' banking markets, notably South Korea's. Yet acquisitions by foreign banks, hedge funds and private-equity funds have for the most part been made opportunistically rather than to fit a grand strategy. If Asia's banks are to become robust, competitive and well-run, and if they are to do a half-decent job of allocating capital in the economy while making a healthy return for themselves, there is a need for much more consolidation and foreign investment.

Some planned foreign involvement has been frustrated by domestic political sensibilities, machinations even. Last year Standard Chartered, with ambitions to become a dominant consumer bank in developing Asia, thought that its bid for Indonesia's Bank Central Asia was in the bag, only to find that the deal was handed to Farallon Capital Management. In South Korea, Seoulbank was originally to be sold to HSBC, but a local outcry against the supposedly cushy terms scuppered the deal, to Hana Bank's eventual benefit. Foreigners are frequently accused of gouging the locals. Even in Japan, the media have claimed that the government's plans for painful bank reform are being carried out at the behest of George Bush's administration, which, in turn, is said to be in the pocket of the American private-equity groups, so-called vulture funds, that buy up distressed financial assets.

HSBC, for its part, does not consider acquisitions like Seoulbank as bonanzas. “We looked hard at banks in Thailand and Korea,” says Aman Mehta, chief executive of HSBC in Asia. “They involve very lengthy

negotiations with governments, while any such acquisition requires a long investment phase before we see a return."

Perhaps when banking sectors are in a state of flux, nimbler, more opportunistic foreigners—private-equity funds, for instance—are better placed. When Newbridge bought Korea First Bank, it pledged to inject capital. In return, it was able to change top management—the bank has a European as chief executive—and streamline branches; it also had wide discretion over handing back inherited bad loans to the government. It was a similar option that locals most objected to in HSBC's bid for Seoulbank.

Newbridge has multiplied the value of its investment in Korea First Bank severalfold. At around the same time, Goldman Sachs put $500m into Kookmin, in return for a minority stake and a seat on the board. At its peak, the investment was worth $2 billion, some of which Goldman has now pocketed by selling down its stake. With hindsight, it looks like easy money. But Richard Gnodde, the head of Goldman Sachs in Asia, tells it differently: "At the time, the risks looked significant. When we made our investment in Kookmin in early 1999, there was a lot of heated debate about it."

The International Finance Corporation (IFC), the private-sector arm of the World Bank, gets credit not just for helping restore confidence by investing in South Korea's financial system, but also for helping spread best international practice—a case of profiting while doing good. The IFC had helped found Hana Bank and Korea Long-Term Credit Bank two decades before the crisis, but in view of the country's economic progress it had sold up and moved on some time ago. When the crisis took hold, the South Korean government asked the IFC to come back and help with these two institutions.

The IFC not only put $50m into Hana Bank and $25m into Korea Long-Term Credit Bank, but also arranged a rigorous programme of technical assistance: recovering bad loans, setting up loan-classification and management systems, improving information technology. Regulators saw what was happening at these two institutions, says Javed Hamid, head of the IFC's East Asia and Pacific operations, and adopted it as a model for the rest of the banking system. Korea Long-Term Credit Bank was subsequently taken over, in much better shape, by Kookmin Bank.

Now that the regulatory and business climate in South Korea has become more predictable, multinational commercial banks and insurers are tying up with local banks. This summer, the principle of *bancassurance* (allowing banks and insurers to own each other and cross-sell their products) is to be permitted for the first time. Kookmin's head, Kim Jung-tae, explains his bank's strategy: "Here at Kookmin, we intend to deliver the financial products of sophisticated countries through our branch network: insurance, mutual funds and savings products." One such supplier will be ING, a Dutch insurer, which already has a stake in Kookmin.

The big multinational banks may not yet dominate the landscape in Asia, as they did in Argentina, and indeed they may never do so (other than in their home bases, such as HSBC in Hong Kong). Yet their relative advantages will become stronger. They can offer new products at lower cost because they can sell them through more distribution channels than can domestic Asian banks. Crucially, they have built huge processing centres that help keep down the cost of acquiring and servicing additional customers around the world. HSBC has centres in Hyderabad, Bangalore and Guangzhou. Standard Chartered claims huge efficiency gains from its new hubs in Chennai and Kuala Lumpur, with a hub in China to follow. "It's not the Korean banks that keep me awake at night," says Mr Kim of Kookmin Bank, "it's the international giants."

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Casino capital

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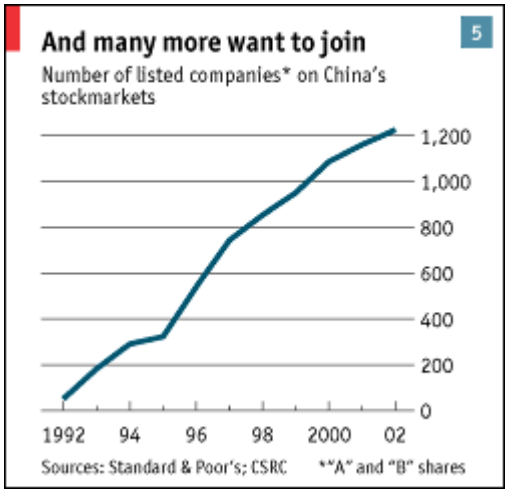
China's financial markets are wild—and often less than wonderful

THE country's financial rise has been vertiginous. Until 1990 China had no stockmarket at all, and until 1993 no Chinese company was listed abroad. Today, the Shanghai stockmarket and its smaller counterpart in Shenzhen between them have 1,200 listings and a market capitalisation of around $500 billion, second in Asia only to Japan. So much for communism: officially, some 66m individuals—more than the population of Britain or France—invest in the stockmarket, with 100-odd brokers and 15 fund-management companies to cater for them. Over the next three years, under China's commitments as a new member of the World Trade Organisation, rules prohibiting the foreign ownership of brokers and fund managers are to be eased. Approved foreign investors will gradually be allowed into the domestic markets, drawing on the example of Taiwan's earlier financial liberalisation. All this, it is hoped, will mark the coming-of-age of mainland China's capital markets.

Meanwhile, Hong Kong has gained a new lease of life as a financial centre by helping to raise foreign capital for the modernisation of state-owned enterprises in mainland China—and, increasingly, investment for China's growing private sector. Chinese companies now make up 35% of Hong Kong's stockmarket capitalisation, against only 7% in 1995. With stockmarket listings in Hong Kong of giants such as China Mobile, China National Offshore Oil Corporation and Bank of China, the mainland accounted for the biggest chunk of the world's international share offers in 2001-02—a welcome boost to global investment banks facing a dearth of new issues in America and Europe.

Yet all is not what it seems in China's capital markets. For a start, growth in the domestic stockmarket has outstripped the efforts—game as they are—of the regulators and the legal system to police it. The authorities say that computer-matching of share transactions has allowed them pretty much to stop powerful syndicates ramping up share prices. They have even sent the biggest manipulators to jail, yet insider trading is still rife on a heroic scale. Stock-exchange executives reckon that the real number of investors is around half the official number: investors use multiple accounts for dodgy share-dealings.



The real issue is the quality of the listed companies themselves, says one financial official. Even some of the better-regarded ones indulge in all sorts of market abuses, such as lending money raised on the stockmarket to the parent company rather than investing it, or speculating in the stockmarket on their own account. Almost all companies allowed a listing are the beneficiaries of government favouritism. Their profitability is usually abysmal, their levels of disclosure poor, and—with the state holding roughly two-thirds of the shares of companies listed in Shanghai and Shenzhen—their treatment of minority shareholders appalling. Most private firms have hitherto been denied access to the stockmarket. Standard & Poor's, a credit-rating agency, counts 35 “private” listed companies in China, but points out that a good number are in fact controlled by local governments and even the military.

The China Securities Regulatory Commission (CSRC), a body of refreshingly modern-minded officials, is only too aware of the shortcomings. It has raised standards and even delisted companies whose performance is not up to scratch. It has introduced quarterly audited financial statements, and a requirement for independent directors on company boards.

Cleaning up the stockmarket may have done much to take the steam out of rising share prices, but therein lies the commission's dilemma. It is alarmed by the inflated valuations of domestic shares, a consequence of the small proportion of a company's shares that are actually tradable, and of investors' enduring belief that share prices are dictated by political signals, not by the laws of supply and demand. At the same time, the Communist Party has a much broader concern: that middle-class dissatisfaction with stockmarket losses, coupled with working-class anger at the continuing wave of lay-offs at state enterprises, could threaten the legitimacy of the party's rule.

Over the past couple of years, the CSRC has been forced to abandon plans to plug the state's $100 billion-200 billion unfunded pension liability by selling government-owned shares. On paper, the scheme was brilliant. By offering a way out of the urban pensions mess, it gave reformists in government a reason to persuade dogged conservatives to let go of state control of industry. In practice, investors took fright at the prospect of the shares of thousands of companies (and not very good ones at that) being dumped on the market. Share prices in Shanghai, until 2001 among the world's best-performing, have slumped. The CSRC has put tight restrictions on new listings—new share offerings halved in 2001 and again in 2002—which has disproportionately hurt the country's private companies, desperate for capital. Last year the commission officially abandoned the share-sale plan for the time being. Having set out to ensure the unfettered working of China's financial markets, the CSRC has ended up as the country's chief allocator of equity capital. No wonder that China's equity markets, for all their impressive size, financed less than 2% of total investment in China last year.

“The equity market”, says a senior financial official, “is dysfunctional. Nor do I think a proper corporate-bond market will develop for a very long time. For instance, there's never been a proper default on corporate bonds in China, and if you had one there'd be a riot. That's why the banks will continue to play a very important role.”

It is the banking system that collects up the bulk of China's great pool of domestic savings, equivalent to nearly 40% of GDP. Sadly, the banks misallocate the savings on an even grander scale than the stockmarkets. The four big state-owned banks that dominate the system direct four-fifths of their lending to state-owned enterprises which destroy value more often than they create it. The vibrant private and export sectors—which have created perhaps 40m new jobs in the past five years, as many as the state sector has shed—are left largely to fend for themselves. They rely on retained earnings and foreign direct investment, or else on informal sources of credit. “Until recently, at least, there has been a big disconnect between those earning money and those borrowing it,” says Paul Coughlin of Standard & Poor's in Hong Kong.

Considerable strides have been made in getting the banking system into better shape. Five years ago the central bank, the People's Bank of China, was given a federal structure that brought decision-making back to the centre and cut across powerful provincial lines. The big four state banks were also recentralised. They have sacked huge numbers of staff: the Industrial & Commercial Bank of China has laid off one-fifth of its employees, a staggering 110,000 people. The banks have hired western consultants to teach them about risk-management systems, credit-scoring and tackling bad loans. Last year, the former head of the Bank of China—intolerably corrupt, it seems, even by Chinese standards—was put under house arrest.

More changes are likely to be pushed through by the new, reformist generation of political leaders. For instance, there is talk about the establishment of an independent bank regulator. But potentially the most interesting development took place late last year when the central authorities gave Newbridge Capital the go-ahead to take a controlling stake in Shenzhen Development Bank. This bank, until now owned by the Shenzhen local government, has 200 branches in the most capitalist city in China, with deposits growing by 50% a year. And, because it is fairly young, it has a much smaller legacy of bad loans than the big state banks.

“In policy terms”, says Weijian Shan, head of Newbridge in Hong Kong, “the significance goes way beyond the deal itself. It says a lot about what's going to happen to the whole industry.” In theory, only foreign banks with assets of over $20 billion may set up in China or take a minority stake in a domestic bank, and even then are not allowed to do local-currency business. Newbridge is not even a bank. What is more, foreigners are not supposed to be able to buy the non-tradable shares—so-called legal-person shares—with which the state keeps control of enterprises. The deal is an indication of how reformists in

central government intend to use foreign capital and management skills as a way to shake up China's banks.

Meanwhile, though, under guidance from central and local political barons, the big banks continue to lend to weak state enterprises—perhaps not as much as they used to, but still far too much. The bad loans this generates are the system's Achilles heel. For several years, the government denied the scale of the problem and pooh-poohed unofficial estimates that put bad loans at 40% or more of the total. But recently a franker assessment by the banks themselves, using international standards of measurement, has brought official figures closer and closer to those earlier unofficial estimates. A best guess by Nicholas Lardy of the Brookings Institution, one of the earliest to draw attention to the problems of China's banks, now puts bad loans in the system at around $500 billion, or over 50% of the total.

In 1999 the finance ministry decided to set up four asset-management companies, one for each bank, to deal with the bad loans. Over the following couple of years the government transferred, at face value, roughly $170 billion of bad loans from the four big banks to their respective AMCs, equivalent to more than one-fifth of the banks' loan books. The loans were almost all made before 1996, and most of them were state-directed “policy” loans. The central-bank governor, Dai Xianglong, said it was the banks' “last supper”. Since then, another $40 billion of bad loans appear to have been transferred to the AMCs. And now, the finance ministry suggests, a further supper might be needed to take a fresh batch of NPLs off the banks' books. After all, even after the relief provided by the first batch, the banks' bad-loan ratio still stands at 22%, according to Guonan Ma and Ben Fung in a recent paper for the Bank for International Settlements.

Now you see it, now you don't

The two authors point to a curious accounting sleight-of-hand that raises questions about where the buck for China's bad loans ultimately stops. In order to buy the $170 billion of banks' bad loans, the AMCs needed to be capitalised. At the outset, the finance ministry injected capital of $1.2 billion into each new AMC—a tiny amount, accounting for just 3% of assets acquired. The People's Bank of China put in quite a bit more cash, say Mr Ma and Mr Fung: up to $50 billion. But in return for that cash, a big chunk of state banks' liabilities to the central bank appears to have been transferred to the AMCs: that is, state banks' debts were forgiven, while new ones owed by the AMCs were created. Lastly, the AMCs themselves issued $140 billion-worth of ten-year interest-bearing bonds. These were given to the banks, along with $40 billion-odd in cash, in return for the bad loans. The AMCs, in other words, have a lot of debt resting on a tiny sliver of capital.

In the long run, the AMCs will be lucky to recover one-third of the value of the bad loans from selling off the underlying assets. So far only 25% of loans, by face value, have been sold. It will come as no surprise if the AMCs are unable to pay the interest, let alone repay the principal, on the bonds to the state banks and on their borrowings from the People's Bank of China. Messrs Ma and Fung argue that the central bank's claim on the AMCs is larger than its own capital base.

This raises the question of systemic risk. If China's insolvent state banks are to be nursed back to health—and any suggestion that they might not be would lead to a run on deposits and a full-blown banking crisis that would send China into turmoil—the government will have to pick up the tab. The cost of cleaning up the banking system needs to be added to the government's already considerable pile of liabilities. But instead of facing up to this, says Mr Lardy, the government shuffles debt around as though it were constructing a Ponzi scheme.

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Come and get it

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Consumer finance is Asian banks' new thing

IT WASN'T just the girls in miniskirts and platform boots handing out credit cards on street corners. What really set the South Korean authorities worrying that the credit boom was getting out of hand were media reports last year that a bank had given a family's pet dog its own credit card. Before the crisis, South Koreans had generally shown a seemingly immutable and rather Confucian degree of financial conservatism and thrift. But afterwards, with interest rates low and banks eager to tap new markets, people began to borrow. Between 1999 and 2002, the issue of new credit cards in South Korea grew at an annual compound rate of 75%. The average number of cards per user has leapt to four.

Traditionally, banks in developing Asia have cared little for the consumer, other than as a cheap source of funds to be shovelled into the maws of the big companies that were their chief customers. Today banks across the region look to the consumer as their source of future profits and try to ply him with credit cards, mortgages, car loans and unsecured credit. Households now account for nearly 40% (and rising) of East Asian banks' total lending, up from 27% in 1997. In South Korea, total household debt has been rising by 25% a year and now accounts for half of all bank lending. Two years ago China's banks had just $6.5 billion in outstanding mortgages; today the figure is five times that. The Bank of China, the least bad of the country's four big banks, expects that in five years' time consumers will account for half of the bank's loans. If that really is right, an end to Chinese banks' problems may be in sight.

From both a policymaker's and a bank's point of view, says Sun-bae Kim, regional economist at Goldman Sachs in Hong Kong, going after the consumer makes sense. Many companies responded to the Asian crisis by cutting dangerously high levels of debt. Companies, in other words, have become much more cautious users of savings. Banks, for their part, are now often wary of lending money to companies, yet they are flush with deposits. The question for policymakers, says Mr Kim, is what will generate future growth in the real economy? The question for bankers is, how are savings to be mobilised in future? South Korea, eagerly watched by its neighbours, offers answers to both these questions. Its domestic demand (and particularly household demand) is already playing a much bigger role in driving growth, relative to the export sector, than it used to. And households themselves are now borrowing on an unprecedented scale—for consumption, to be sure, but also for investment, through purchases of residential property.

Salomon Smith Barney, part of Citigroup, calls consumer finance “the single most powerful theme in Asian financial services”. The investment bank says that lending to consumers is vastly more profitable than to companies. Credit cards, for instance, can generate a risk-adjusted return on assets of 5% or more, compared with 0.2% for the most commodity-like of corporate loans. What is more, says the bank, even in markets where mortgage penetration seems pretty high (Hong Kong, Singapore, Thailand and Taiwan), plenty of room exists for other products to catch on: revolving credit-card loans and unsecured loans, for example.

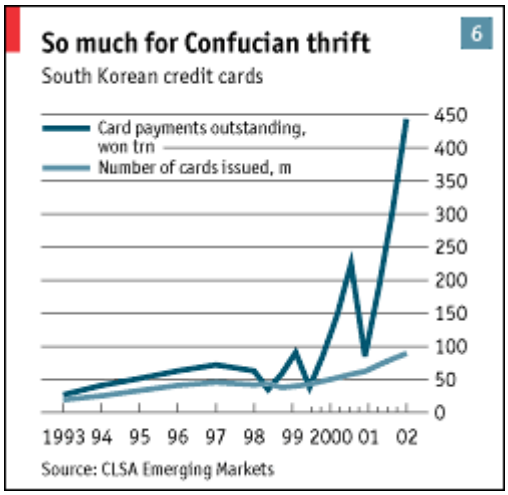
Both Visa and MasterCard say that developing Asia will for years remain their fastest-growing market. GE Capital has a highly profitable credit-card business in Thailand (where it was able to charge interest rates of up to 30%, until the government imposed a ceiling of 18%). Last month Citigroup, the world's biggest bank, won approval from the Chinese government to take its first minority stake in a Chinese bank: 5% of Shanghai Pudong Development Bank, for $112m. The ability to promote credit cards and other consumer-finance products through Pudong's 270-odd branches is a chief attraction as restrictions on foreign banks' own operations continue (HSBC, the world's second-biggest bank, has a similar stake in Bank of Shanghai). Under the terms of China's WTO accession, foreign banks may not issue domestic-currency cards until 2005.

The processing side of credit cards benefits hugely from economies of scale. Break-even point for a processing centre is reckoned to be at least 400,000 cards. In South Korea, with about 90m credit cards, the leading banks are already doing well out of this business: Kookmin Bank, for instance, has a lucrative one-third market share in credit cards. In Thailand, with a smaller market, some local banks have teamed up with international card specialists to tap into regional economies of scale. The population of Singapore, at 4.5m, despite its affluence is too small for this business to be able to flourish in isolation, which is one reason why the city-state's banks, notably DBS Bank, are pursuing a twin strategy of domestic consolidation and regional expansion.

Know your customer

Building up a profitable consumer-finance business is no easy ride, even in countries where much demand remains unmet. Many banks will take a tumble. For a start, a consumer-finance operation needs a good deal of money for training, marketing, branding and information technology. In order to offer people the products they really want, banks must have a clear idea of customers' behaviour, which requires minute analysis of customer information. Banks must also have a clear picture of customers' profitability. A better understanding of these issues may lead to a radical reappraisal of how different customers should be treated. For instance, low-spending customers may need to be encouraged to use ATMs rather than take up staff time in costly branches.

Other challenges for banks in developing Asia include poor payment infrastructures and low card acceptance by merchants. More important, banks in most parts of the region have no way of discovering the credit record of anyone coming through their door. In the West, credit bureaus allow banks to share information on a prospective customer, such as whether he has defaulted on a loan. Not even South Korea has a full-fledged system of credit checks yet, says Dominic Barton, the South Korea head of McKinsey, a consultancy. In Shanghai and Shenzhen, credit bureaus are in their infancy, and elsewhere in China they are absent altogether. Banks in Hong Kong, the region's most sophisticated economy, merely circulate a voluntary blacklist of offenders. Hong Kong, at least, has courts through which banks may pursue claims. Yet in other parts of Asia banks have little or no legal recourse against defaulting borrowers.



There is no doubt that consumer finance is radically reshaping, and improving, the business of some Asian banks. It is even helping to reshape some economies—but only some. South Korea's large economy has enough household demand for consumer finance to make a difference, and so do China's and Japan's. Yet the economies of South-East Asia are still too small for that. Banks there can too easily get seduced by the idea of consumer finance, says Andrew Stotz, a banking expert in Bangkok.

In Thailand, for instance, the credit-card business has been growing by an average of about 15% a year, with some banks recording double that rate of growth. Yet card loans still account for a mere 1% of banks' portfolios, says Mr Stotz, and personal loans for only 6%. Mortgages make up as much as 14% of portfolios, but mortgage lending is actually falling because of a sticky domestic economy. In this part of Asia, consumer finance is not going to drive most banks' profits for some time to come.

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Capital markets are good for you

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But in Asia they will take time to build

ASIA boosters at the international investment houses have called the stockmarket wrong before. “Maximum bullish”, said Barton Biggs in 1993 about China and Hong Kong, weeks before a prolonged slump. “Back up your truck” and load up on Asian shares, was a notable miscall a few years later. Those equity strategists that remain in the region—a diminished tribe, because many second- and third-tier investment banks have shut up shop—are no doe-eyed ingenues. They understand Asia's challenges. Yet they point out that over the past three years Asian equities (as measured by the MSCI Asia Free ex-Japan index) have fallen by nearly half, even as returns on equity have risen and corporate indebtedness has fallen. They think insufficient attention is being given to more positive factors—not least that, for all its shortcomings, Asia is and will continue to be the world's most dynamic region by far.

Timothy Moe, Asian equity strategist at Goldman Sachs, sets his case for a sustained period of outperformance on three pillars. First, cyclically, and despite a rally from 2001 to early 2002, emerging-Asian equities are currently at the bottom end of historical valuations, both in absolute terms (measured by price/earnings ratios and implied equity-risk premiums) and relative to developed markets (measured by price/earnings ratios and by market capitalisation to GDP). Moreover, because of Asian economies' and stockmarkets' sensitivity to the global economic cycle, any world recovery in 2003-04 would be magnified in the performance of Asian shares—but then so would any slump.

Second, says Mr Moe, many beneficial structural changes have taken place in Asia since the crisis. Macroeconomic stability has been much improved, this time with the advantage of flexible currencies leading to more stable growth. People are also changing their behaviour, with profound and exciting consequences.

The growth of consumer credit in South Korea, which this survey has highlighted, is one example. Mr Moe mentions others. One is the growth in Chinese domestic demand, and the possibilities that this raises for China to act as an engine of growth for the region rather than an economic threat. Over the past two years, imports for domestic use (as distinct from imports for use in China's vast export industries) have shot up, with China now running a trade deficit on such goods. Another striking change is the growth across the region in tourism from mainland China. Mainland visitors to Hong Kong, for example, now spend more per head (over $5,000 a visit) than do Japanese visitors, once famous for queuing outside the Louis Vuitton store in Central district.

Third, Mr Moe predicts fresh flows of money into Asian equities. Overseas shares, for instance, are now heavily under-represented in the portfolios of American equity mutual funds, at only 13% of the total, compared with 19% in 1994. After three years in a row of awful returns on American shares, some money might now be expected to be placed elsewhere. If American mutual funds were to bring their international shareholdings up to the levels of 1994, $210 billion of liquidity would be sent around the world, a good amount of which would find a home in Asia. Add to that pool another, local one: in the medium term, there is huge potential for the development of Asia's nascent pension-fund industry (see chart 7).

When will my saver come?

It is the old wall-of-money theory, and it is all very plausible, but there are two important caveats. One is a near-term caution about the degree of political risk that has suddenly re-entered the region in the past few months. The bloody terrorist bombing in Bali last November, and a wider understanding of the extent of Islamic fundamentalist operations in Indonesia, look certain to undermine that country's important tourist sector and knock general economic confidence for the next couple of years at least. The Philippines, too, has a terrorist problem, in the form of extortionist gangsters masquerading as Islamists, operating mainly in southern Mindanao province; and personal safety is an issue throughout the country, with knock-on effects upon economic confidence.

More alarming by far is the nuclear brinkmanship of North Korea's leader, Kim Jong-Il. Many of the supporters of South Korea's new president, Roh Moo-hyun, are inclined to blame America's hawkish stance for North Korea's nuclear re-armament. A nuclear threat alongside strained relations with an ally makes for deep uncertainty, which could easily spill over into financial markets.

The other caveat is about a conceptual issue. If Asian stockmarkets do rise on a wall of money, it will be partly because there are still precious few options available to international investors. South-East Asian economies are generally too small to support more than a handful of companies large enough for the biggest institutional investors to bother with. Hong Kong, Taiwan and South Korea have bigger economies and a longer list of sizeable companies. But even there, the shares are relatively illiquid; a majority of companies are family-controlled, with a fairly small “free float” of tradable shares. International investors dislike illiquid shares because they are more expensive to buy and sell, and during periods of market stress may be impossible to sell at all. Moreover, minority shareholders are all too often taken for a ride, even in Hong Kong, which has the region's highest standards of regulation and corporate governance.

And China? Foreign investors are denied access to the domestic stockmarket. Many of the country's biggest companies, admittedly, are listed in Hong Kong, and at the height of the China craze overseas investors raced to buy every new issue. Yet many of these companies are government-owned former monopolies—and for the most part act like it, even though competition is eroding their franchise. Now that the shares of several of these mainland listings trade below their issue price, foreign investors are becoming disillusioned. It is telling that the world's greatest story of economic success has produced the worst share performance: in the ten years to the end of 2002, Chinese shares in which foreigners may invest recorded an average annual loss of 16%.

Need to have, not just nice to have

The inadequacies of Asia's capital markets, where corporate-bond markets are even less developed than stockmarkets, are the flipside of a dominant banking sector that intermediates four-fifths of the region's investment, compared with just a quarter in America. The crisis has indeed spurred some changes for the better in the way that banks in the region assess credit risk, and their new approach to lending is more cautious and disciplined. That caution, in turn, has led to better corporate governance among borrowers. Kookmin Bank in South Korea tries to encourage such efforts by charging a lower rate of interest for borrowers that meet certain corporate-governance criteria, such as having independent board directors. Yet the crisis has not broken the banking sector's dominance in mobilising savings and monitoring company performance. Why not?

Mario Francescotti, a senior manager at Morgan Stanley in Hong Kong, argues that the infrastructure for deep, well-functioning capital markets cannot be built without the participation of the dominant banks. That, he says, is the lesson of the development of Europe's capital markets over the past three decades, specifically the vast Eurobond market, where European banks such as Credit Suisse, Deutsche Bank and Paribas all played a big part. In developing Asia, the dominant banks fear losing their loan book to disintermediation, and governments have failed to prod the banks to develop capital-market alternatives, except in Hong Kong and Singapore. To do so would risk a fresh credit crunch, as banks called in their more doubtful loans and market discipline penalised undeserving companies. Lack of progress on capital markets, in other words, is part of the price of governments' tacit support for forbearance towards doubtful borrowers.

An overwhelming body of economic opinion concludes that not only do banking systems and capital markets complement and strengthen each other; together, they also drive economic growth. Asia does not even have a regional forum for the development of capital markets, though Andrew Sheng, chairman of Hong Kong's Securities and Futures Commission and an acute observer of the region's shortcomings, proposes an Asian Financial Institute to get the discussion going. Still, it will be a long time before the

region has meaningful markets that do a good job of mobilising savings and pricing risk.

Might China be different? Some observers think so. Admittedly, China's financial markets are more behind than most: of all China's markets—labour, goods, services, capital—the last is the only one still monopolised by the state. Yet that is changing. On the banking side, the big four banks are slowly being restructured, quasi-private banks are being encouraged, and foreign banks are making inroads and will make more, given China's WTO commitments. When the domestic banks are in better shape, interest rates will be liberalised, probably within the next five years.

Crucially, a new generation of reformist leaders takes over the government's reins next month. It is already considering the merits of getting a functioning capital market to sit alongside the banking system. Some who believe that capital markets are a necessity, not a luxury, are moving into positions of authority. Zhou Xiaochuan is moving from the securities regulator to run the People's Bank of China. Wen Jiabo, who currently oversees financial matters as a vice-premier, is expected to become prime minister.

Small beginnings

Morgan Stanley's Mr Francescotti, for one, believes the seeds for proper capital markets in China have been sown. Citizens are already being given a greater choice of savings vehicles. Foreign insurers are entering the country, ready to offer new savings products, with AIG of America the first to get a full licence. Foreign fund managers are being allowed to set up joint ventures with local firms to sell mutual funds to the Chinese. A prodigious amount of work remains to be done, but there will be ways to check for progress as time goes on. For instance, unless a meaningful bankruptcy law, already delayed for years, gets on to the statute books within the next year or so, people should start worrying.

It is just conceivable, then, that China can make the running in regional financial matters, just as it is making the regional economic running now. Either way, if the Asian miracle is to revive, the whole region will need to show a great deal more political imagination, leadership and courage than it has done to date.

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Asian reserve

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From The Economist print edition

A heap of foreign currency isn't always a good thing

MOST developing regions have a surplus of labour but a shortage of capital. Developing Asia is different. Certainly, it has a surplus of labour, a huge one now that China has joined the world economy; but it also has a surplus of capital. Not only are Asia's savings rates extraordinarily high (nearly 40% of GDP in China), most economies in the region also run hefty current-account surpluses and pile up dollars. Where do these dollars go?

Mainly to the region's central banks, rather than to individual citizens. Asian central banks hog the world's foreign-exchange reserves (see chart 8). Governments see their hefty reserves as an insurance against the vicious swings of a globalised economy—and against any future crisis on the scale of 1997-98. The reserves are their virility symbol.

Oddly, though, the money is not doing much good in the region. After all, capital markets there are neither deep nor liquid enough to absorb them. Rather, the dollars go back to the rich world, notably to America. Asia funds something like half of America's huge current-account deficit, and Asian central banks are among the biggest net foreign purchasers of American Treasury bonds. And then the dollars come back to Asia in the form of portfolio flows and foreign direct investment: not the same dollars, true, but money is fungible. Andrew Sheng, chairman of Hong Kong's Securities and Futures Commission, says that it reminds him of the debate in the 1950s about money from Britain's colonies going to the imperial centre and coming back in the form of colonial investments.

A growing body of opinion is starting to question Asia's high foreign-exchange reserves. Increasingly they are being viewed less as a virility symbol than as a kind of covert tax—a cost of the region's imbalanced model of export-driven growth and of a vulnerable financial sector. Still, few citizens really begrudge their governments holding the world's super-currency, particularly when so many of those governments have a recent record of debasing their own monies.

The risk to the high-reserve policy is a steep fall in the dollar. Most Asian central bankers still won't hear of this. A world dollar standard has, in effect, prevailed since the gold standard was abandoned in 1971. And the Federal Reserve under Alan Greenspan has been a staunch guardian of sound money. Yet there is a danger of deflation in America, and after a series of interest-rate cuts the Federal Reserve has only 1.25 percentage points above zero to play with.

Late last year one Federal Reserve governor, Ben Bernanke, explained that the Fed, if necessary, had abundant powers to avert deflation. “Like gold,” he said, “US dollars have value only to the extent that they are strictly limited in supply. But the US government has a technology called a printing press (or, today, its electronic equivalent) that allows it to produce as many US dollars as it wishes at essentially no cost. If we do fall into deflation, we can take comfort that the logic of the printing-press example must assert itself.” Asia's central banks had better watch out.

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The IT revolution

The best thing since the bar-code

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Alamy

Smart labels may be about to change the way that companies distribute and sell almost everything they make

AT A Tesco's supermarket in Cambridge, England, the shelves have begun to talk to their contents, and the contents are talking back. Soon, razors at a Wal-Mart store in Brockton, Massachusetts will begin to let staff know when they suspect theft. This spring, a group of firms will attempt to track, in real time, many thousands of goods as they travel from factory to supermarket shelf. Consultants tout cost savings and extra sales that could run into tens of billions of dollars a year.

The reason for the sudden buzz of excitement is a new, supercheap version of an old tracking technology called Radio Frequency Identification (RFID). RFID systems are made up of readers and “smart tags”—microchips attached to antennas. When the tag nears a reader, it broadcasts the information contained in its chip. In the past four years, the cost of the cheapest tags has plunged, from $2 to 20 cents. In the next two to three years, prices are likely to fall to five cents or less. Already, RFID tags are made in their millions and used to track pets and livestock, parts in car factories and luggage at airports. Last month, Gillette announced that it had put in an order for half a billion smart tags, signalling the start of their adoption by the consumer-goods industry. If they catch on, smart tags will soon be made in their trillions and will replace the bar-code on the packaging of almost everything that consumer-goods giants such as Procter & Gamble and Unilever make.

The inspiration behind the new, cheap tags is a partnership between academic researchers and business called the Auto-ID Centre, based in Cambridge, Massachusetts. Founded in 1999, the centre boasts 87 member companies, including the world's biggest retailers and consumer-goods firms. Traditional RFID tags, says Sanjay Sarma, the centre's research director, carry all their information. That makes them big and costly—fine in small numbers, but expensive in the sorts of quantities that the consumer-goods industry might want. Procter & Gamble, for instance, makes 20 billion products a year. So Mr Sarma has stripped the information his tags carry to the bare minimum—a single serial number. This serial number is unique, identifying the exact can of fizzy drink or bottle of shampoo on which it is stuck. But detailed information about the product—what it is, where and when it was made, and so on—is stored on a computer elsewhere, to be looked up as needed via the internet.

When less information is more

Nobody had got it, says Kevin Ashton, who runs the centre. Big technology firms such as Intel and Motorola thought it was impossible to build a tag costing a few cents. Traditional RFID makers, who grew up without the internet, did not understand the beauty of removing information from the tag and storing it centrally. So Messrs Sarma and Ashton did the work themselves, designing specifications for a new chip and inventing new software and network services to support their idea.

Abandoning the likes of Intel, Mr Ashton and Mr Sarma turned instead to a handful of start-ups. One of them, called Matrics, says that it is now ready to start making the new tags. The price will depend on volume, says Matrics' boss, Piyush Sodha. If Matrics makes 1 billion tags a year, they will cost ten cents apiece, he says. At 10 billion tags a year, the price falls to five cents. Gillette is buying its 500m tags from a firm called Alien Technology, which has pioneered a promising low-cost manufacturing technique that involves suspending chips in liquid, then flowing the liquid over the chip mounts. Mr Ashton expects other members of the Auto-ID Centre to place big orders (some exceeding Gillette's) for tags this year.

Gillette is piloting two uses for its tags. The first combines smart tags with “smart shelves”, which are fitted with tag readers. Gillette says that retailers and consumer-goods firms in America lose around $30 billion a year in sales because shop shelves run out of products and stand empty. On Gillette's smart shelves, the tagged razors let the shelf know when they are coming and going, and the shelf keeps count. If it gets too empty, the shelf sends a message to store staff to fill it up. Because Gillette's razors are small, valuable and easily resold (for evidence, visit eBay), they are also often stolen; tags and shelves will do double duty as security against theft. If the shelf notices that lots of razors have left at the same time, it alerts staff.

Gillette is also piloting the use of smart tags to track products as they move from factory to supermarket. Using bar-codes, this can be a labour-intensive, error-prone task. Readers can scan smart tags automatically as pallets of products pass along conveyor belts and through loading bays. That will reduce shipment errors and cut theft, argues Gillette. Because manufacturers can be certain that they are shipping the right quantity of goods to the right place at the right time, they can also afford to shrink the inventories they maintain in case of error. Consultants at IBM have worked with six member companies of the Auto-ID Centre. Their work suggests that smart tags can shrink inventories by 5-25%, says IBM. If so, the increase in efficiency of inventory management during the past two decades, thanks to “just-in-time”, “Dell-isation” and so forth, will take another huge leap forward, helping to keep America's recent productivity miracle going—and, with luck, spreading it to the rest of the world.

Having finished two field trials, Mr Ashton says that most technical difficulties are now behind them. “We are ready to go,” he says. Following pilot projects this year, says IBM, companies will start deploying smart tags in earnest in 2004, beginning with pricey, oft-stolen goods such as razors, cosmetics and pharmaceuticals. If all goes well, Matrics and Alien Technology should be making tens of billions of tags by 2005 or 2006.

The biggest worry is that consumers might reject smart tags because they seem too invasive of their privacy. If firms link products to customers at the checkout, ordinary objects could become traceable to their purchasers (imagine a stray coke can at the scene of a crime). Following Gillette's announcement, e-mails sent to the RFID Journal, an online trade magazine, hint at some of the concerns. “I'll grow a beard and fuck Gillette,” wrote one reader.

Here too the Auto-ID Centre seems ahead of the game. Its chip specifications include a “kill command” that can permanently disable the tag. The centre is working on a privacy policy, a draft of which gives the customer the option to kill tags at the checkout. The customer would forgo after-sales benefits, such as better warranty and returned-goods services, for instance, or chickens that could tell ovens how to cook them. But the kill command is just the thing for those who suspect that their fridge has begun to spy on them.

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Pinault-Printemps-Redoute and Gucci

A costly luxury

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François Pinault discovers that it doesn't always pay to be in fashion

CALL it the high price of ego. François Pinault, one of France's richest businessmen and main owner of Pinault-Printemps-Redoute (PPR), a big European retailing and distribution group, fought a vicious battle with his arch-rival, Bernard Arnault, boss of LVMH, a big luxury-goods group, for control of Gucci, an Italian luxury-goods house. Mr Pinault appeared to win when he took control of Gucci in a deal signed with LVMH on September 10th 2001. But the deal has turned into a disaster, forcing PPR into a restructuring and asset sales so as to raise cash to pay for the part of Gucci still owned by others.

The cause of the disaster is an option written into the peace agreement with Mr Arnault. It gives minority shareholders in Gucci the right to sell their shares to PPR in March next year, at a fixed price of $101.50. PPR could not have predicted that terrorist attacks in New York the next day would dampen prospects for the luxury-goods industry and weigh on Gucci's performance. But from the start the option looked onerous. If exercised, PPR would have to find around $5 billion, a huge sum given that it already has big debts.

In recent months Gucci's share price has fallen well below the level of the option (see chart). That has reflected uncertainty about whether PPR will honour the option contract (it says it will) or instead try to negotiate new terms; and also the relatively poor performance of Gucci itself. In early December Gucci unnerved investors by issuing a profit warning. Its results for last year appear to have been worse than those of rivals, including, ironically, LVMH. Some analysts think that, without the support of the put option, shares in Gucci would be trading at nearer $60 than their current $93. Maybe even lower.

This is a huge headache for PPR. To ease the pain it has been buying Gucci shares in the open market, raising its stake from 54% to around 58.2% now, with more purchases to come. Gucci is also using some of its cash to buy 3.5m of its own shares, equivalent to 3.4% of the total, ostensibly to allow staff to exercise share options. All of these purchases save PPR money that it might otherwise have to shell out next year. Indeed, PPR has the right to increase its holding to 70% before March 2004. That would mean it spending perhaps $1.4 billion before then, depending on the share price. But even then there would still be a further 30m Gucci shares to buy.

The financial cost of Mr Pinault's ambition is the difference between what he will have to pay for the minority shares and the true value of Gucci in today's weak market. Assume that Gucci shares are worth $60 each (some analysts have suggested a “worst-case” valuation of only $40); PPR's overpayment then comes in at around $2 billion. Rich as he is, Mr Pinault can scarcely afford such waste.

Where is the cash coming from? PPR, which has around *euro*5 billion ($5.4 billion) of net debt, is in effect being broken up for cash. This debt figure takes account of most of the proceeds from the *euro*3.6 billion sale announced late last year of Finaref and Facet, its two main consumer-finance and credit businesses. It is also planning to exit the business-to-business sector that currently generates half of its annual revenues. Full details of PPR's debts and disposal programme will be given on March 5th when the group announces its results for 2002.

Serge Weinberg, PPR's boss, says that the group is in the process of becoming a retailing and luxury-goods firm based around the core Gucci brand. That is putting a brave face on what amounts to a

business catastrophe. Small wonder that PPR's own share price has fallen by half in the past year and is now less than one-quarter of its level in late 1999.

There is a further risk for PPR in this strategy. Gucci is strongly identified with two men who are well-regarded in the industry: Domenico De Sole, its managerial boss, and Tom Ford, its creative director. Both have lucrative share-option grants that will make them independently rich when they choose to exercise them. Both have contracts that are due to be renewed next year. Mr Ford in particular may have ambitions to move beyond Gucci, especially if he has by then enhanced his reputation by fixing the group's troubled Yves Saint-Laurent brand. Mr Pinault might then suffer the consequences of yet another larger-than-life ego.

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Tall buildings

Onwards and upwards

Feb 6th 2003 | NEW YORK
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So much for the death of the skyscraper

Reuters

Majesty restored?

PLANS for buildings that are not just big but truly huge adorn the walls of Kohn Pedersen Fox (KPF), an architectural firm in New York. Some aspire to 200 storeys. In the aftermath of the World Trade Centre's collapse 18 months ago, such towering dreams seemed to have no chance of becoming reality. Yet on February 13th, ground will be broken in Shanghai for a KPF design that is intended to be the world's largest building: a tapering, multi-angled structure that will seem truly to scrape the clouds. In April KPF will complete work on a Tokyo complex with a central skyscraper that will feature one of the highest occupiable floors in Japan. Submissions are being readied for still bigger projects in several different countries.

Even embattled New York is re-entering the competition for the title it held for much of the 20th century. On February 4th, two schemes were put on a final shortlist to go up on the site of the World Trade Centre, either of which would become the highest structure in the world. (Occupiable floors would not reach so high.) The reason? So “that the majesty of the Lower Manhattan skyline be restored,” says John Whitehead, chairman of the Lower Manhattan Development Corporation.

Whether “majesty” makes business sense is the subject of intense debate. Europe has largely stayed out of the skyscraper race. A proposed 66-storey London Bridge Tower, which would be the continent's largest building, may eventually go up. It would not stand out in Manhattan.

Executives in the City of London, Europe's largest financial market, contend that even in a non-earthquake-prone area, once a building rises much above 50 storeys the demand for additional elevators, stairwells and structural supports makes them unacceptably inefficient.

True, up to a point, says Paul Katz, the architect at KPF in charge of the Tokyo and Shanghai projects—but the most efficient building is not necessarily the most valuable. There are some explicit benefits from skyscrapers, notably efficient energy usage, plus less tangible ones such as the savings and benefits that come from clustering employees in one place. Typically, where firms most like to operate, sites are scarce. As a result, it often makes sense to add floors, even at ever greater cost.

Under a master plan for the Pudong region, the Shanghai World Financial Centre, to start next week, will be one of only three buildings to exceed 50 storeys. Work was delayed in 1998 due to the Asian financial crisis. But renewed growth is raising demand. KPF is working on a skyscraper in Hong Kong that will be almost as tall as the one in Shanghai. Another near-record-breaking tower is being built in Taiwan.

Skyscrapers have risen slowly in Japan due to earthquake fears, but now they are going up. The central Roppongi Hills building will be just under 60 storeys and may be the sturdiest in the world, claims KPF, because of the breadth of the floors it stacks atop each other—many of as much as 5,500 square metres (60,000 square feet), compared with the former World Trade Centre's 3,600 square metres. Early tenants include such investment banks as Goldman Sachs and Lehman Brothers.

With New York's economy suffering, redundancies mounting and continuing fear of terrorism, it is hard to

imagine anybody financing new construction in the city, let alone a vast new skyscraper on a site that many believe should be used only as a memorial. The new plans have already run into critics, concerned that both repeat the World Trade Centre's inability to mesh with life on the street, undermining the vitality that characterises neighbourhoods in great cities. But the business of erecting large buildings unfolds over decades. By 2010, or 2015, the economic climate will have changed. Perhaps the fears of terrorism will have abated as well, and the plans will have evolved.

Even before the events of September 11th, construction techniques were changing to resolve shortcomings that existed in the 1960s when work began on the World Trade Centre. Rather than being supported merely by steel curtain walls and thin connecting beams, the new skyscrapers have concrete cores linked to strong columns in the outer walls. Stairwells are pressurised to repel smoke and entered only through air-lock-style vestibules. Space is reserved every dozen floors or so for refuges. Special elevators are reserved for firemen.

Nobody now underestimates the devastation that would be caused if an aircraft strikes a building; but at the least, the new crop of tall buildings are designed so that they would not collapse if hit by even the largest passenger plane. That may not sound particularly reassuring to anyone asked to work on the 100th floor. But the business of building to the sky dates back at least to the Tower of Babel—and no disaster has stopped it for long.

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Venezuela's oil crisis

Oil's not well

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Iraq aside, expect further disruption

"NEAR normal." That is how Venezuela's oil industry will be by the end of this month, says Ali Rodriguez, the country's oil minister. Managers at the state-run oil monopoly, PDVSA, had tried to force out President Hugo Chávez by shutting down the flow of black gold for the past couple of months. Oil production collapsed from some 3m barrels per day (bpd) a few months ago to below 200,000 bpd in December. But this week, the strike fizzled out. Now, says Mr Rodriguez, production is up to 1.8m bpd and soaring.

So oil's well in Venezuela, is it? Not quite. Certainly, the nightmare scenario for world markets—a raging crisis in Venezuela and a hugely disruptive invasion of Iraq—has receded with the end of the Venezuelan strike. Such a "two front" disruption might have wreaked havoc in oil markets, for the potential loss in supply—of 5m bpd or more—would have been unprecedented. The spare capacity maintained by the OPEC oil cartel, even when combined with strategic stocks held by big consumers such as America, would simply not have been enough to counter such a massive disruption of supply.

Indeed, with the Venezuelan strike fading, OPEC ministers are already talking of a coming oil glut. Were an invasion of Iraq to go smoothly, they argue, the oil market could be over-supplied. After all, they agreed only last month to raise production quotas by 1.5m bpd. And oil consumption is sure to drop with the start of the northern hemisphere spring. Bijan Namdar Zangeneh, Iran's oil minister, this week went so far as to proclaim: "If we have Iraq and Venezuela sustaining production, I am sure we will have to reduce production in the second quarter."

Such worries of price collapse may be justified eventually, but there is probably more immediate reason to fear the opposite: that the world economy may encounter some nasty after-shocks from the Venezuelan strike. One reason is that the harm done to the world's stocks of oil, gasoline and other products has yet to be fully felt. Indeed, analysts at Goldman Sachs, an investment bank, argue that the crisis in Caracas has "created one of the largest shocks in the history of the oil market—one that already exceeds the anticipated disruption resulting from a war with Iraq." Although the market may be pricing in a risk premium for an Iraqi war, it is underestimating the impact of the Venezuelan disruption, they conclude.

The country's oil industry has been crippled—perhaps permanently—by the strike. Oil production is now closer to 1m-1.5m bpd than the 1.8m bpd that Mr Rodriguez claims. And it has little chance of rising to 2m bpd (let alone a "near normal" 3m bpd) unless the government quickly injects billions of dollars in investment.

Much of the country's oil is a particularly heavy crude that is technically complex to harvest. Unusually large investment is needed merely to keep the oil flowing: some fields have a natural "decline rate" of up to 25% a year. Yet, under Mr Chávez, the national oil company—even before the strike—was forced to neglect this. Instead, oil revenues were redirected to political ends. The question of whether that money might ever return is, to say the least, uncertain.

One motive for the strike was the anger of senior PDVSA managers, triggered when Mr Chávez started replacing competent veterans at the top of the firm (pre-Mr Chávez, it was considered one of the best-run state oil monopolies, for what it is worth) with political cronies. As many of the best and brightest managers and technical experts have now left the firm (and maybe the country), experts suggest that Venezuela's oil industry may never recover from this crisis, even assuming that Mr Chávez does the sensible thing—which, given his famously erratic behaviour, would be an heroic assumption.

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The future of television

Heave ho, TiVo!

Feb 6th 2003
From The Economist print edition

TiVo may be struggling, but the revolution it promised is only on hold

THE news that TiVo is to stop selling its digital video recorders (DVRs) in Britain looks like final proof that the device has flopped. Best-known for its ad-skipping ability, TiVo also bred a scary new television culture in which the intelligent set-top box guesses your tastes and records viewing on your behalf. At least two recent American TV shows have played on the desperate attempts of baffled men to outfox their machines by recording lots of porn films or macho war movies because their TiVos think they are gay.

At its launch in 1999, TiVo promised more: to be a revolutionary gadget that would upend the TV business, undermine the advertising industry and free viewers from the tyranny of TV schedulers. But, with just 510,000 subscribers in America and Britain combined, and the firm making another operating loss, of $46m, in the nine months to October, is the revolution now over?

Certainly, the take-up of TiVo has been disappointing against what was once projected. Nor does it look good to quit its only foreign market. (TiVo's existing British subscribers will be served by BSkyB, a pay-TV firm with a rival DVR system.)

Yet TiVo offers something genuinely useful: a tapeless video recorder, which stores programmes on a hard drive, and has an on-screen menu that is as easy to use as an internet site. No more messy piles of video cassettes, no more fiddling around with the clock on the video recorder, no more missing an episode of a favourite show by mistake (TiVo automatically records the whole season) and—with the ability to put a live broadcast programme on pause—no more missing the crucial moment in the soap if the doorbell rings. TiVo's failure has been to come up with a simple way of explaining all this. As Nigel Walley, of Decipher, a media consultancy, puts it: “What you can do with it is astonishing, but it is very hard to sum up the benefits in a few words.”

In fact, the demise of TiVo in Britain marks not the death of the technology but a shift in the strategic development of DVRs. TiVo will still sell its subscription service in America. But it is concentrating its efforts on licensing its technology to hardware manufacturers and pay-TV operators. Already, TiVo supplies its DVR technology to DirecTV, America's biggest satellite-TV operator. Sony also licenses TiVo technology for its DVRs, but, in Japan, does not even use the TiVo brand.

Once TiVo-like functions are wrapped into the new all-in-one set-top boxes, and once the price of those upmarket boxes comes down, the prospect of take-up will improve. Tony Ball, BSkyB's boss, reckons that about 20% of its 6.3m subscribers will upgrade to Sky's DVR system within the next four years (38,000 use it now). Forrester, a research group, expects that 16% of American households will have a DVR by the end of 2005, up from 2% today.

There is also the lure of exclusive content. It was the inclusion of extra snippets that helped to drive the phenomenal recent growth of DVDs, another technology whose demise was falsely predicted in the face of disappointing early take-up. DVR operators are now also beginning to offer users exclusive clips or interviews.

The revolution that the DVR threatened in the TV industry was to destroy the economics of broadcast television, now based almost wholly on advertising revenue. Although the ad industry has been slow to realise the need for alternatives to the 30-second spot, this is starting to change. Sponsorship and more subtle forms of product placement have spread. The most creative advertisers hope that the DVR, 70-80% of whose users regularly skip commercials, will prove an opportunity as much as a menace. BMW recently released another series of its pioneering advertiser-funded short films, involving such talents as

Ridley Scott and Gary Oldman, which it put both on the internet and into TiVo systems. If the ads are funny or clever enough, America's couch potatoes seem willing to volunteer to watch them.

The point about the DVR revolution is that it will not undermine all advertising—just bad advertising. As TiVo found last month by monitoring users, more of them watched the best commercials, such as one for Reebok, during the 2003 Super Bowl than watched the game itself.

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Music in advertising

The death of the jingle

Feb 6th 2003
From The Economist print edition

Advertisers don't want fake pop. They want the real thing

NOT long ago, rock stars would turn up their politically correct noses at the notion of using their precious songs to sell anything as crass as cars or cornflakes. In the 1980s Sting, a British singer, refused to allow the lyrics of “Don't Stand So Close to Me” to be used in a deodorant commercial. Now Sting is an unabashed advertising star. One Jaguar commercial in America shows him meditating in the back seat to the tune of a recent hit. With traditional sources of revenue falling, the music industry, having become comfortable with its music being used over the years since Sting's protest, is now desperate to get advertisers to use original pop songs to sell everything from handbags to hamburgers.

This trend, which media types call “synchronisation”, is leading to another: the decline of the jingle. Once pop songs in their own right (America's first radio jingle, Pepsi's “hits the spot”, became a jukebox hit in 1939) catchy jingles such as Mars's “work, rest and play,” or General Electric's “bringing good things to life”, are being discarded. Despite the $90,000-plus cost to license a pop song (compared with $15,000 for a customised jingle), advertisers, especially those aiming at younger consumers, think it money well spent. This year's Super Bowl ads included a DaimlerChrysler spot with Celine Dion trilling a song written for the ad while driving a sleek new Crossfire. Old timers, from the Rolling Stones to Led Zeppelin, are earning extra royalties for no extra work. But new bands are benefiting too. Britain's Dirty Vegas became overnight stars when Mitsubishi used their edgy music in American commercials. Audi has just taken a bet on a tune by an unknown British singer, Dog.

Adrienne Dunlop, commercial-markets director at EMI Music, calls synchronisation “an explosive trend”. Her division's profits have doubled in the past four years. “We have 20 ads in Britain alone featuring our artists, and more are coming.” The record companies are creating multimedia campaigns to support the ads. Ms Dion's car deal, devised by Sony, spans print, TV and the internet, with personal appearances where she promotes Chrysler cars and, of course, her own records.

Meanwhile, spare a thought for the jingle writers. Ronnie Bond, who created some of Britain's best-loved ones, including Cadbury's Flake's “crumbliest, flakiest, milk chocolate” (still running, against the trend, after 30 years), used to write five jingles a week. He admits that, now, one a month “would be an exaggeration”. Tony Satchell, boss of Candle, a British firm of commercial composers, criticises the lack of risk-taking in today's ads: “Composers were once integral to building ad campaigns. Now creatives are scared that an untested jingle will scupper a project. They only offer music the client already knows.” Jeff Rosner, head of AMP, which represents commercial composers in America, says that business fell by 25% in the key $150m New York market last year. In both America and Britain, many music firms are going bust. For Candle, cheap technology and re-recording old hits are keeping it afloat. But, muses Mr Satchell, “It's depressing, isn't it? The death of the jingle.”

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Telecoms in South Africa

No longer on hold

Feb 6th 2003 | JOHANNESBURG
From The Economist print edition

At last, South Africa is selling its state-owned telecoms firm

JUDGING by the anxious looks and hollow eyes of the men and women who are launching South Africa's biggest privatisation effort, the next few weeks will be agony. A quarter of Telkom, the country's state-owned telecoms firm, is due to be floated on March 4th. But after two years of failed promises and halting starts, the minister of public enterprises, Jeff Radebe, is having to repeat the mantra that this time there will be "no turning back". Despite gloomy market conditions and a possible war with Iraq, he is determined to see it listed in both New York and Johannesburg next month.

In today's market, the price will have to be on the low side. Two years ago officials might have raised four times the 4.6 billion-5.7 billion rand ($550m-680m) they now expect for the 139m shares on offer.

Yet it may still make sense to go ahead. President Thabo Mbeki wants to reassure investors that his government is committed to privatising South Africa's many state utilities despite opposition from his trade union allies. There is now a strong appetite for shares among the black-majority population, which it would be good to satisfy. Around 1.5m people have registered an interest in the offer, almost all seeking a 20% discount available only to non-whites. And there may also be political and administrative advantages in getting the sale out of the way before campaigning begins for next year's general elections.

The sale of Telkom may also attract an unusual degree of attention (though not necessarily money) from foreign investors, as the promotional roadshow moves from South Africa to Europe to America during the next weeks—if only because hardly anybody else is bringing a company to market at this time, especially in telecoms. Foreigners have invested before: an American-Malaysian consortium bought a 30% stake in Telkom for $1.3 billion in 1997.

The firm is in decent shape. Its fixed-line business is not growing, despite heavy spending to connect new lines to rural customers. But the government last week rejected two bidders for a licence to run a rival phone company, so Telkom remains a monopoly. Its biggest opportunity comes from owning half of Vodacom, one of the country's three mobile-phone operators. About 13m people now use mobile phones in South Africa, says Alan Knott-Craig, Vodacom's boss; he expects that to rise to 19m. He also plans to expand into other parts of Africa and to boost the use of non-voice services, such as text messaging.

After this sale, the government would keep its remaining stake in Telkom for at least two years. But it plans other privatisations, both to raise revenue and to increase efficiency and competition in the lacklustre economy. Hitherto, the privatisation programme has been anything but a triumph, raising questions about the government's commitment. In 1997-2001, privatisations raised only 19 billion rand. Last year, the government sold a stake in M-Cell, a phone and internet firm, but botched that of a forestry company. A 20% stake in South African Airways, sold to Swissair in 1999, was bought back (albeit at a big discount) after the Swiss airline went bankrupt. The government says it wants to sell that portion again. Denel, an arms and aerospace firm, could follow, along with Aventura, a holiday-resort company. The real jewel is Eskom, a profitable and fast-expanding energy company. But judging by how long it took to drag Telkom to market, that politically charged sale may be a long time coming.

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Airlines in trouble

Flying dinosaurs

Feb 6th 2003
From The Economist print edition

American Airlines, the world's biggest airline, may soon fly into bankruptcy

THE key to flying is to defy gravity. Increasingly, for America's biggest airlines, that challenge is more financial than physical. Two are flying under bankruptcy protection from their creditors; more may follow soon. They are being dragged down, not just by the shock of September 11th 2001, but by a slump in business travel, by overcapacity created in the profitable late 1990s, by the success of low-cost carriers such as Southwest and JetBlue, and by cheap fares on the internet.

This combination of cyclical woes with structural change threatens the existence of America's network carriers. Frederick Reid, president of Delta Air Lines, likens September 11th to the meteor strike that allegedly destroyed the dinosaurs by creating a “nuclear winter” which the creatures that ruled the world could not survive.

So it is with America's network carriers, all of which risk going bankrupt because the economic conditions that sustained them are gone. Business travel may some day bounce back and overcapacity may be competed away. But the challenge of low-cost carriers and greater price transparency will not disappear. The bursting of the dotcom bubble cut business travel. Newly cost-conscious firms realised that the airlines had been (in Mr Reid's words) “gorging” on the high returns they could extract from business travellers seeking last-minute flexible tickets. Those days are gone forever now that travellers can surf the internet for cheap unsold seats. So the only mainstream airlines that will survive are those that can cut their costs and raise productivity to compete with the ubiquitous, profitable low-cost carriers.

For most of the network carriers, with strong unions and costs per seat up to twice those of the no-frills carriers, this could prove impossible, even after taking advantage of bankruptcy protection. United Airlines is struggling to cut wages enough to persuade the court and banks that it should get more money within Chapter 11. If it fails to produce a convincing plan by the middle of this month it could swiftly be liquidated under Chapter 7 of the bankruptcy code. US Airways, the first airline in the latest round of Chapter 11 filings, faces the same challenge, but its managers, workers and suppliers seem to be getting a grip on its worst problems.

American Airlines, which reported the industry's biggest-ever loss ($3.5 billion) last month, is now losing $5m a day, which it is covering by borrowing. It is only halfway through a programme to slash $4 billion from its annual costs of $21 billion. It has introduced leaner flight operations and streamlined ticketing. For instance, spreading flights at its Chicago and Dallas hubs more evenly throughout the day has let it cut five aircraft from its fleet and use fewer gates. Simplifying its fleet from 12 types of aircraft to only five brings further savings in areas such as engineering and maintenance. But this was the easy part.

Now it has to renegotiate its labour contracts. Wages at American swelled, as at other airlines, after United started paying big rises in 2000, sowing the seeds of its bankruptcy. This week American asked the unions representing pilots, ground staff and flight attendants for $1.8 billion off the wage bill. The airline is hoping that its tactic of first cutting operating costs before turning to the workforce for concessions will lead to more co-operation.

On past form, unions have (as at United) failed to deliver enough, except under the lash of bankruptcy. If American cannot persuade its workers to take a cut to keep a job, it looks set to follow US Airways and

United into Chapter 11. The risk is that bankrupt airlines, sheltered from creditors, will be run for marginal revenues, spreading the pain via cheap fares to stronger carriers such as Delta, Continental and Northwest Airlines. There could then be a blood-bath, similar to the 1980s frenzy that sealed the fate of such once-great airlines as PanAm, TWA and Eastern Airlines.

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Sabena's bankruptcy

Call for Poirot

Feb 6th 2003
From The Economist print edition

Poor advice and unusual deals hastened Sabena's demise

FEW people who had anything to do with Sabena, a Belgian airline that went bust in November 2001, will enjoy a new report on the affair, published by Belgium's parliament on January 29th. For a start, the report hardly flatters McKinsey, the world's best-known management consultancy. Under de facto control by Swissair (which went bust in October 2001), Sabena brought in the Belgian arm of McKinsey, a favourite of Paul Reutlinger, then Sabena's Swiss boss. McKinsey recommended for Sabena the same high-risk strategy for growth that its Swiss arm had sold to Swissair. The report dryly concludes: “This strategy...was as fatal to Swissair as it was to Sabena.”

The report also focuses on two very odd deals that Mr Reutlinger made with Brussels-based Virgin Express, an airline bought by Sir Richard Branson, a British entrepreneur, in April 1996. Fearing competition, on October 29th of that year, Mr Reutlinger and Sabena's vice-chairman signed a one-year deal with Virgin Express on Sabena's London-Brussels route. Virgin's planes and crew would fly the route, using Sabena's Heathrow slots; Sabena would pay Virgin Express for 85 seats per flight, filled or not.

That in itself is not unusual. What happened next is. Later that day, Mr Reutlinger signed two similar deals with Virgin Express, for Sabena flights to Rome and Barcelona. Not only were these deals for eight years, but the deal done earlier that day was extended to eight years. Christophe Müller, Mr Reutlinger's successor at Sabena, told the inquiry that these deals were a “serious cash drain”, costing up to *euro*30m ($32m) a year. Without them, Virgin Express might have gone to the wall, he claimed. Moreover 80% of Sabena's customer complaints related to Virgin flights.

The report concludes that Mr Reutlinger exceeded his powers and that Sabena's board did not ratify his actions. The report reaches a similar conclusion over another of Mr Reutlinger's deals with Sir Richard. In March 1997, without a mandate from the board, he sold Sabena's slots at Heathrow for $8m to Virgin Atlantic Airways, another of Sir Richard's airlines. Virgin states that it has no idea why Mr Reutlinger did these deals. It also says that Virgin Express has prospered since Sabena's fall.

There may be more revelations to come. Acting on a complaint from a Sabena employee in 2001, a magistrate in Brussels has been looking into possible corruption at Sabena.

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Face value

An American in Bangalore

Feb 6th 2003
From The Economist print edition

Having prospered in America, Vivek Paul is applying what he learnt back in India

VP Communications

FROM a rooftop in Wipro Technologies' development centre in Electronics City near Bangalore, you can watch the company grow. On a Saturday morning, the centre, where some 6,000 of Wipro's 13,000 staff work, is in weekend mode. The open-air amphitheatre where, last November, Bill Gates, a sort of touring messiah, spoke to his disciples, is deserted. The restaurants, classrooms and sports facilities are underused. Inside, most computer terminals are unattended. But new buildings are rising relentlessly. The campus is supposed to accommodate 17,000 by 2005. With hardly a machine in sight, streams of men and sari-clad women shift earth and rubble in baskets perched on their safety helmets: the old India is building the new.

Managing Wipro's part in this modernisation is Vivek Paul, president of Wipro Technologies. If the campus—earth-shifting technology aside—seems more Californian than Indian, then so does he. Although Indian-born, he has the crunching handshake, steady gaze and up-to-the-minute jargon of a Silicon Valley information-technology mogul—which is what he is. He has made his career in America: running General Electric's medical-scanner business and then a GE joint-venture with Wipro. He now has his corporate headquarters in Santa Clara, California.

This is appropriate. Wipro aspires to be a global force in the IT industry, and its biggest market will remain America. It is also surprisingly unusual. Thousands of Indian IT professionals work in America. But unlike Taiwan, where returnees from America helped build a computer industry, India's émigrés have so far played only a small part in their own country's software boom. No more than a few dozen work in Wipro's management.

In 1999, Mr Paul was hired by Azim Premji, the chairman, majority owner and son of the founder of the erstwhile Western India Vegetable Products company. When he hired Mr Paul, Wipro's share price was soaring, thanks to the dotcom bubble. It even became India's biggest firm by stockmarket value.

Heady days. But despite the IT slump, Wipro was India's 25th-biggest firm in 2002 measured by sales and its fourth most-valuable company, just ahead of a Bangalore rival, Infosys. (The biggest Indian software company, TCS, part of the Tata group, is not listed.) Mr Paul has presided over three years of over 70% annual growth in profits, as cutbacks in America's IT industry have inspired a wave of outsourcing to companies such as Wipro and Infosys, with their low Indian cost bases.

Wipro's history is one of successful opportunistic diversification. This has led it out of the vegetable (cooking oil and then soap) into the mineral (variously light-bulbs, printers, scanners and personal computers) and ultimately into the cerebral, renting out software expertise, largely to Americans. Wipro is now a body-shop—a global back-office for hire, a business more elegantly described by Kiran Karnik, president of Nasscom, the national industry association, as “brain arbitrage”.

The process can be seen through the window of a “global command centre” on Wipro's campus. Engineers have two screens on their desks—their own and one mirroring what another engineer, working in England for Thames Water, a British utility, is watching; thus, any glitches can be fixed in India. Elsewhere entire floors are devoted to firms such as Lehman Brothers, an investment bank, and Weyerhaeuser, a timber giant. As it has taken on ever more complex operations for its clients, Wipro has changed, in Mr Paul's words, from being a company of “coders” into one of project managers. Now, he

says, for the next big transformation: into “architects and consultants”.

It is a process that is under way across the Indian industry. Nasscom's Mr Karnik talks of “one-stop shops”; Nandan Nilekani, managing director of Infosys, of becoming a “business-solutions provider”. All want to move up the value chain before India's cost advantage is beaten by somebody else. Already, margins are under threat, both from foreign firms establishing their own Indian operations, and from other countries. In the long run, that means China—the only place with the scale and clout to provide a serious challenge. Conventional wisdom is that Wipro and its peers have only three to five years' breathing-space.

Wish they all could be Californian

If it is to compete successfully in IT consultancy with multinationals such as Accenture, PricewaterhouseCoopers, EDS and IBM, Wipro accepts that it must become less Indian. That involves both increasing the proportion of non-Indian staff, from 3% now to more like 15% in the next couple of years, and also what Mr Paul calls “people transformation”. The average age of its staff is 28; 40% of them have been at the firm for less than two years. After excelling at giving the customer what he wants because he knows best, they will have to become consultants, who not only know better but also are unafraid to say so.

For Mr Paul this is part of the unstoppable globalisation of services. In his analogy, IT-services firms are the “neighbourhood forge shops” of the age—if you want something made, you pay them a visit. Like forges, they will over time give way to bigger international producers offering economies of scale. But Wipro, unlike some Indian firms, will not take this analogy to its logical conclusion and become a big seller of its own branded software products. Service providers, says Mr Paul, “cannot afford to compete with their customers.”

In his campus sermon last November, one customer, Bill Gates, told the Wipro congregation that, together, they and Microsoft could take on IBM. It was a very American message, both in its focus on Microsoft's own competitive priorities and in the modesty of its implied role for Wipro, as the service provider backing up its products. But it somehow captured both the enthusiasm and the realism of the young Wiproites' aspirations. And it earned the touring messiah his biggest cheer.

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Rating agencies

Exclusion zone

Feb 6th 2003
From The Economist print edition

Regulators promise a belated review of the ratings oligopoly

THE domination of any industry by three firms ought to set regulators thinking. Does their power distort markets? Is lack of competition damaging? So it is in the world of credit ratings, where two big agencies, Moody's and Standard & Poor's (S&P), and one smaller one, Fitch, hold sway. The Securities and Exchange Commission (SEC) was asked by Congress last year to review their role.

At the end of March the SEC will publish a paper that attempts to deal with concerns not only about competition in the rating business, but also about possible conflicts of interest, and the need for greater transparency and perhaps tighter regulation. Don't hold your breath. The world is awaiting the SEC's conclusions from a similar initiative begun in 1997.

If there is a lack of competition, the SEC is largely to blame. Only the three top agencies enjoy the status of “nationally recognised statistical rating organisation” (NRSRO), awarded by the commission. Some others have applied in vain, because the SEC will not divulge the criteria for election to this exclusive club. Since 1975, when NRSRO status was invented, the chosen few have thrived in their protected market—and taken over any newcomers that achieved NRSRO status.

The agencies' status and the way capital markets have evolved have given their ratings a semi-official authority. Many investors use their ratings of issues of securities as an inflexible investment criterion. Some investors, such as pension funds, may not buy assets rated below a certain level. Rating downgrades or upgrades are often used as a contractual signal of a borrower's creditworthiness: a downgrade can trigger a demand for more collateral, a higher rate of interest on a loan or bond, or even an immediate repayment of debt.

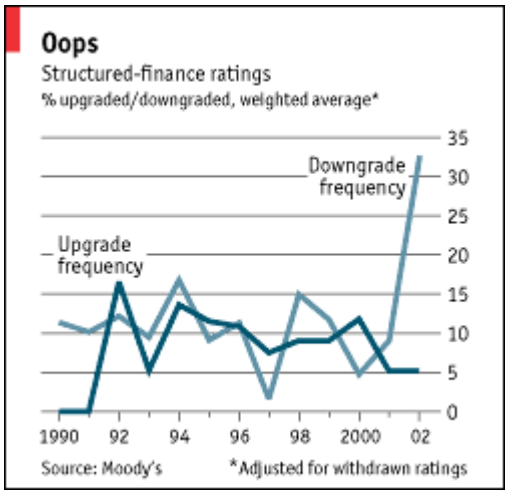
Some fear this can create a cliff down which a hard-pressed borrower can quickly tumble. When many borrowers run into trouble at the same time, changes in ratings can stoke up volatility, and precipitate liquidity crises and even defaults. The crises can be more sudden and unexpected if the existence of a “rating trigger” is not publicly known. Rating agencies have recently begun to take account of such triggers.

The use and abuse of ratings

Just as troubling is the increasing use of ratings, not just to appraise securities but also as a motive for their creation and marketing. Nowhere is that truer than in so-called structured products—bundles of assets sliced into different layers of expected risk and return. The selection and slicing are done in close discussion with a rating agency, so that each slice is awarded the appropriate rating. Then the slices are sold to investors with appetites for each grade.

Even some market participants agree that this is putting the cart before the horse. Assets tend to be selected to conform with agencies' credit ratings and measures of diversification. The trouble is that ratings, which in S&P's terminology range from AAA to BBB- (for investment-grade credits) and below that from BB+ to D (for default) are not as finely graded as market judgments of creditworthiness. Of two credits rated B, one could be a healthy company; the other could be close to default.

The temptation, when manufacturing a structured security, has been to stuff cheaper (and riskier) assets in each rating class into the portfolio. This has sometimes meant fun and games for traders, who have been able to arbitrage between assets carrying different risks but the same rating. Managers of these pools of assets have played similar games between rated and unrated slices. It seems that the agencies may have been rating what cannot be rated, at least with their existing crude toolkits. They have had problems in recent months in their traditional business, downgrading the debt of once-great companies. Not surprisingly, their ratings of the new exotica have also had to be adjusted often (see chart).



“We may be incompetent,” says one rating-agency veteran, “but we're not dishonest.” Certainly, no equivalent of Jack Grubman or Henry Blodget has been unmasked among the ranks of rating analysts. Rating agencies have long insisted that their greatest asset is their reputation. Even their failure to spot the impending bankruptcies of Enron, WorldCom and Global Crossing until seconds before their default has been blamed not on lack of integrity, but on lack of street wisdom.

Ratings are a handy benchmark for the buy-and-hold investor, but not necessarily for the trader who has to react to the market mood. Unfortunately, by accident rather than by sinister design, ratings have become a driver for trading as well as investing in the capital markets.

The recognised status of the three main agencies and the real but invisible barriers to entry by others aggravate the problem. In 1997 the SEC proposed criteria for recognition; but since then it has given no guidance to applicants. One of these, Sean Egan, managing director of Egan-Jones Ratings Co, says that an SEC official told him: “We won't tell you the criteria, otherwise you might qualify.” Another complains that for years a single SEC bureaucrat has blocked progress on this issue.

Things are likely to get worse. Reforms of bank-capital rules by the Basel committee, known as Basel 2, due to come into force in January 2007, will require bank regulators to use agencies' ratings as a basic measure of the riskiness of a bank's credit portfolio. Other rating agencies may win recognition around the world by 2007, but the judgments of the big three are bound to predominate. A study by the Bank for International Settlements on credit-risk transfer, published last month, frets about the reduced incentive for banks to monitor their borrowers once securitised loan pools are rated.

The SEC has a responsibility, not just in America, to get its next steps right, because the big three's ratings cover the globe. It has already examined and rejected the solution of abolishing NRSRO status but said last month that it would explore “viable alternatives”. Regulators “should not be scared” of opening ratings totally to competition and accepting that agencies make mistakes, says a director of one recognised agency. If ratings became just another feature of the market, fears of distortion and a lack of competition should diminish.

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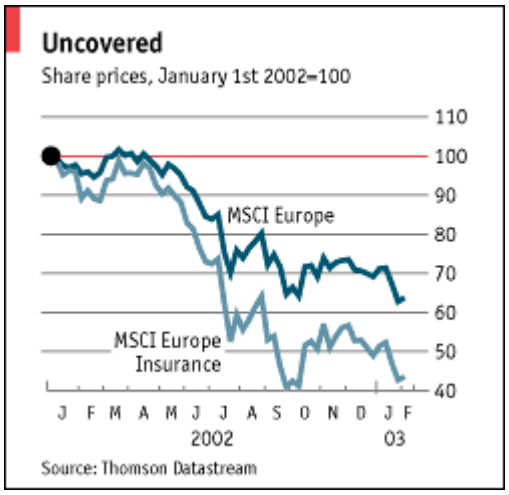
European insurers

The morning after

Feb 6th 2003 | ZURICH
From The Economist print edition

Europe's troubled insurance companies are making belated efforts to manage their investment portfolios and to underwrite risks more wisely



DRAMATIC changes, says Phil Ryan, are under way for Europe's insurers. For years they lived off huge, unrealised capital gains and did not focus on costs or pricing. Now three years of falling stockmarkets have forced them to correct a legacy of over-investment in equities and reckless underwriting during the bull market.

Winterthur, a retail life and non-life insurer owned by Credit Suisse, a Swiss banking group of which Mr Ryan is chief financial officer, is in the midst of just such an overhaul. Last October Credit Suisse had to pump SFr2 billion ($1.3 billion) into the insurer, on top of SFr1.7 billion in June. Winterthur also dumped shares for bonds, cutting the weight of equities in its investment portfolio from almost 20% to close to nothing. Leonhard Fischer, a German investment banker, was hired as chief executive from the start of this year. Some non-core businesses were sold. More will be.

The cure seems to be doing some good: Winterthur returned to profitability in the fourth quarter of 2002. But problems remain. The advantages for Credit Suisse of owning an insurer are not obvious: the bank, it is thought, would like to sell Wintherthur. So far, says Mr Ryan, bank branches have been good at selling insurance, but he concedes that the insurance arm has been less adept at pushing banking products. Mr Fischer knows all about the difficulties of *bancassurance*: his previous employer, Dresdner Bank, was bought in 2001 by Allianz, Europe's biggest insurer, and has been nothing but a burden.

Most insurers are struggling with problems similar to Winterthur's, but few have an indulgent parent willing to inject billions. Last year, for instance, Swiss Life, Switzerland's sickest life insurer, sacked its chief executive, started to sell non-core businesses and cut more than 1,500 jobs, but had to turn to its shareholders for SFr1.2 billion.

Back to bonds and basics

By now almost all Europe's insurers have moved much of their investment out of equities and into fixed-income securities. They are thus becoming more like American insurers, which hardly invest in equities and take more credit risk. Yet Martin Kauer, chief financial officer of Converium, a Swiss reinsurer, thinks an over-reliance on bonds might be dangerous too, if interest rates rise again. “It all depends how well portfolios are hedged against an increase in interest rates,” he says.

Insurance companies will have to do more than scoot out of equities, sell peripheral businesses and change bosses to win back investors' confidence. Last year was catastrophic, even by 2002's demanding standards: the industry's market capitalisation fell by about half (see chart). Insurers must price their policies in line with the risks of paying out. Hitherto they have competed fiercely on rates, accepting underwriting losses which they have then made up with investment gains.

Those days are gone, or at any rate going. AXA, a French insurer, had a combined ratio (claims plus expenses, divided by premiums) of 111% in 2001. By last June it was down to 106%. It is set to fall again. Non-life firms' average combined ratio is still hovering around 105%; life insurers' is a bit over

100%. The ideal is below 100%.

The most obvious way of improving insurers' finances is through increases in premiums. However, this is easier in non-life insurance than in life. For example, customers have to renew their car insurance every year. Although they can shop around for the cheapest deal, they have little choice but to put up with higher prices if premiums are rising in the industry.

Many life-insurance contracts, on the other hand, are investments that run for several years. Premiums can be raised on new business, but not so easily on existing contracts. Worse, life insurers have limited discretion to boost their finances by reducing payouts to policyholders. They must honour guarantees they have given in the past, even if these put their finances under strain. German and Swiss insurers are required by law to pay guaranteed returns. Although guaranteed returns on life policies have been cut to 3.25% in both Germany (for policies taken out after 2000) and Switzerland, this is unlikely to suffice.

British life insurers have lately been using their discretion over payouts as fully as they dare, especially on “with-profits” policies, with which many Britons hope to pay off mortgages. They have slashed both annual bonuses and the final bonuses that make up a large chunk of policies' final values. On February 3rd Standard Life, Europe's biggest mutual life-insurer, reduced bonuses for the third time in a year. Three days later, Abbey National, Britain's sixth-largest bank, said that its life-insurance subsidiaries would pay no bonuses at all this year to many of their customers.

The British life firms are particularly fragile, because they invested more in equities than their continental peers did. At the end of last year, Standard Life still had more than half its portfolio in shares. Falling stockmarkets have forced British insurers to sell to stay within regulatory solvency limits, and this has driven markets down more. On January 31st the Financial Services Authority, Britain's financial regulator, relaxed insurers' solvency requirements for the fourth time in 17 months to break the vicious circle. But even if equity markets recover, many insurers, both in Britain and on the continent, will not. The rapid reduction of their exposure to equities means that a market rebound will bring only partial relief.

Oswald Grübel, one of Credit Suisse's two chief executives, explained when Mr Fischer's appointment at Winterthur was announced that the ex-banker could make up for his lack of experience in insurance with expertise in risk control. Insurers might have been expected to know all about risk already. Clearly, they did not.

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American International Group

Fessing up

Feb 6th 2003 | NEW YORK
From The Economist print edition

Even the mighty AIG is admitting to problems

IN THE beleaguered insurance industry, American International Group (AIG) has long held itself out as a company apart. Slowly, however, its aura of infallibility is fading. The company's share price, already 50% below its peak in 2001, was sent spinning again this week, when AIG announced a $2.8 billion provision for underwriting losses.

The losses have nothing to do with asbestos claims, the chief scourge of American property-and-casualty insurers. They have been incurred instead in such everyday business as workers' compensation, health care and company directors' liability. This is worrying. It suggests either that AIG's stringent underwriting standards have been relaxed or, just as bad, that its past profits were bloated by inadequate provisions.

In a conference call, AIG's gruff chief executive, Hank Greenberg, blamed the losses on a “liability bubble”, inflated by rising jury awards, and a “dotcom bubble” of litigation against directors. “He didn't mention that there had also been an AIG stock bubble,” comments David Schiff, author of *Schiff's Insurance Observer*, an industry newsletter.

Despite soaring premiums for property-and-casualty insurance, profits at a company that investors once saw as a perpetual-growth machine will now almost certainly stagnate for the third year in a row, adds Mr Schiff. Results for the fourth quarter of 2002 are due on February 13th. It is hard to expect any good news from its large division peddling equity-linked variable annuities, particularly those sold years ago with guarantees against stockmarket losses. The aircraft-leasing business, another huge area for AIG, has surely been affected by airlines' troubles.

Two rating agencies, Fitch and Moody's, have negative outlooks on AIG's triple-A rating. Although the company remains strong, a higher cost of credit would affect its ability to finance its large derivatives portfolio. A lower share price also makes it less easy to look for acquisitions.

In response to such concerns, AIG has become a bit more candid about its internal operations. But only a bit. Not until January 28th did Mr Greenberg, aged 77, finally announce that he had appointed a successor, and even then he refused to say who it might be. Now that there are a few scratches on AIG's image of invincibility, investors and creditors might want to know who Mr Greenberg expects to insure them against more nasty surprises.

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Commodity prices

Material evidence

Feb 6th 2003
From The Economist print edition

The prices of most raw materials have been surging

THE sharp rises in the prices of oil and precious metals over the past year, largely reflecting market jitters over looming war, have attracted a lot of attention. Less noticed, however, has been the climb in other commodity prices. *The Economist* all-items commodity price index has risen by 21% in dollar terms since January 2002, its fastest rate of growth since 1994. This sits oddly with widespread worries about deflation. Are commodity markets signalling that global recovery and higher inflation are on the way?

Past experience might suggest they are. Whereas big swings in oil prices usually reflect supply shocks, and precious metals are often seen as a safe haven in times of crisis, *The Economist's* commodity price index (which excludes oil and precious metals) has traditionally been a fairly good leading indicator of turning-points in global industrial output. Commodity prices respond much more swiftly to changes in demand than do consumer prices. However, a closer look at the individual components of the index suggests that this time supply constraints, not rising demand, are the biggest explanation of rising prices.

The metals index, which tends to be most closely correlated with global industrial production, has gone up by only 12%, much less than the index as a whole, since January 2002. Most of the increase in metals prices has happened in the past month or so, suggesting some speculative buying as investors, with war looking likelier by the day, have sought the apparent safety of real assets. Copper prices have also been boosted by supply constraints. Moreover, most of the rise in prices is due to the weakness of the dollar. In euro terms, the metals index has lost 8% in the past year. Indeed, in euro terms the all-items index has fallen (see chart).

The latest surge in commodity prices is different from their previous lift-off, in 1994. The rise then was driven mainly by higher metal prices, as the world economy picked up steam. This time the bulk of the increase in our all-items index is attributable to foods (up by more than 20%, on average, from early 2002) and non-food agricultural products (such as wool and cotton), which have gained 34% overall. Both increases have mainly been caused by shifts in supply, not demand.

Food prices took off in mid-2002 as a result of poor harvests in several big exporting countries. The cocoa price has almost doubled over the past year, reflecting the civil war in Côte d'Ivoire. Even coffee prices, which had been falling for several years, have perked up. Cotton prices have jumped by two-thirds from their late-2001 trough, mainly because of bad weather, which damaged crops. Vegetable oils have seen price gains of around 50%, again largely for supply reasons.

Even if commodity-price increases mostly reflect supply factors, rather than a strong upturn in global demand, is there a risk that these will quickly feed into higher inflation? Janet Henry, an economist at HSBC, thinks not. With inflation close to a 40-year low and firms complaining about their inability ever to put up prices, she argues that higher commodity prices are more likely to squeeze profits than to push up inflation. In these conditions firms will find it hard to pass on the higher costs of raw materials. It is corporate bosses, not central bankers, who need to worry.

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Japanese banking

Giveaway

Feb 6th 2003 | TOKYO
From The Economist print edition

Foreign banks are paying each other to borrow yen

HERE'S a rarity: banks that pay borrowers to take their money. The lucky ones, alas, are not ordinary customers—businesses and consumers—but other banks. After years of near-zero interest rates, Japanese overnight call rates turned negative on January 24th for the first time in history: one European bank lent two others ¥15 billion ($127m) and paid (rather than charged) them 0.01%. Since then, estimates one bank, about ¥600 billion has been lent at negative rates.

This is happening because Japan's sickly banks are finding it prohibitively expensive to borrow dollars to finance their international operations. They have turned, in desperation, to foreign-currency swaps, exchanging yen for dollars from foreign banks. The foreigners are said to be getting a spread of almost 0.1% out of the swap. So paying other banks 0.01% to borrow the yen they have taken off the local banks still leaves them a tidy profit. The business is expected to last until at least the end of March, as Japanese banks usually need more dollars before they close their books at the end of the financial year.

Why do the foreign banks not keep the yen in cash, which costs nothing, rather than lend at negative interest rates? The reason is that many European banks have hit internal limits on their overnight deposits at the Bank of Japan, the central bank. Indeed, says Brian Waterhouse of HSBC Securities, several banks seem to have lowered these limits.

Other uses for the money are unappealing. Holding government bonds, which yield next to nothing, is increasingly risky: Japan's credit rating, top-notch five years ago, has been downgraded three times in 14 months. Lending to Japanese financial institutions or companies is less appetising still. Better to pay other foreign banks to take yen. If this carries on, though, it could push the yen down in the foreign-exchange markets. “The danger,” says Mr Waterhouse, “is that outsiders may think that foreign banks are giving away yen as if they're worthless.”

All of this gives the lie to claims, often aired in Japan, that the weakness of big domestic banks explains why the country's businesses find it hard to get credit. That even healthy foreign banks will not lend to companies is a sign that ultra-low interest rates do not compensate lenders for rising corporate-credit risks, says Mitsuhiro Fukao, a professor at Keio University.

So much, too, for the Bank of Japan's attempts to boost credit creation by pumping money into the economy. As for Japanese consumers, they probably wonder what all the fuss is about. Nobody is paying them to borrow. At the same time, their deposits earn virtually nothing, and they are charged commissions for such services as out-of-hours cash withdrawals. They have, in effect, been enduring negative interest rates for years.

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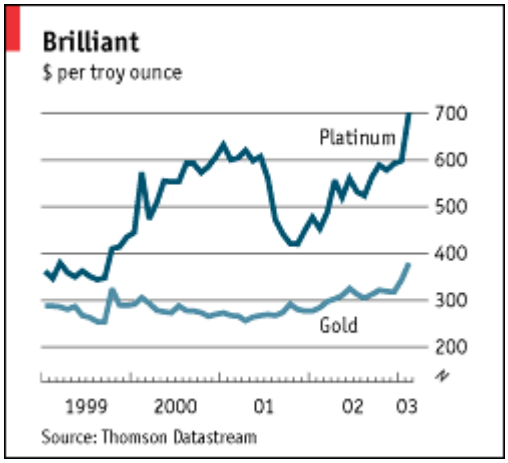
Precious metals

Going platinum

Feb 6th 2003 | JOHANNESBURG
From The Economist print edition

Causes and effects of soaring precious-metal prices



ALL that glisters is not gold. Granted, the price of the yellow metal reached $385 an ounce on February 5th, its highest since September 1996. But lately platinum has been shining even more brightly. Its price on February 4th hit $700, a 23-year high and 17% more than at the end of 2002. Why?

In part, blame war talk, especially for the surge in gold prices. For platinum, however, there are more mundane reasons for the recent climb. South Africa produces around half the world's supply of the metal, which is used for jewellery and in catalytic converters that cut car pollution. But Russia, another big producer, has almost stopped exports, as it builds stockpiles ahead of a probable miners' strike. Some in Johannesburg suspect a Russian plot to force up prices, so that carmakers switch to using Russian-produced palladium in catalytic converters. Palladium is in the doldrums, fetching only $260-odd an ounce, a quarter of what it did two years ago.

Plot or not, other forces are pushing platinum upwards. George Bush has said that he wants more research into fuel-cell technology for cars. That also relies on platinum as a catalyst to produce cleaner electricity, so investors expect demand to keep rising. Meanwhile, limited global supplies cannot easily be expanded. Even in South Africa, a rapid rise in platinum exports is unlikely before 2005.

Higher prices are a welcome boost for the country, although some companies may not benefit immediately because they have locked their prices for the coming months. In the first half of 2002 gold accounted for 13% of South Africa's exports, and platinum nearly as much. Rising gold and platinum prices helped push the rand up by 40% against the dollar in 2002. This year the rand has risen by another 3%. A stronger currency will be handy in paying for oil and other imports. But it could also hurt exporters of manufactures. That would take off some of South Africa's platinum shine.

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About sponsorship

Accounting

Holier than thou

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European sanctimony over American accounting scandals is misplaced

EVER since the bankruptcy of Enron, European accountants have been quietly congratulating themselves. It couldn't have happened here, they say. American rules on accounting and auditing are clearly not all they were cracked up to be. Some officials even hint that Europeans have better morals. American businessmen, they believe, with their corporate jets and stock options, are simply greedier.

However, now that the Sarbanes-Oxley act has reformed America's accounting regime, Europe's systems for ensuring the accuracy of company accounts look full of holes. Accounting firms in America are now banned from undertaking many types of non-audit work for audit clients. In Europe, by and large, there are few such restrictions. America has a new, independent body to oversee auditors. In Europe, many countries leave accountants largely to regulate themselves, and auditors' work is seldom checked independently. Only rarely are companies forced to restate their accounts after they have flouted accounting standards. Chief executives with compliant auditors can get away with publishing questionable numbers.

Britain is trying hardest to catch up. Yet, whereas America's Securities and Exchange Commission (SEC) has made 1,200 companies correct their audited accounts in the past five years, Britain's equivalent, the Financial Reporting Review Panel, has demanded only 15 restatements in the past dozen. It has just one full-time accountant and investigates only if there is a complaint about a company's figures. In most of its 67 inquiries since 1991 it has let companies off in return for promises not to sin again. Now the main financial regulator, the Financial Services Authority (FSA), says it will start searching actively for dodgy accounting, although the panel will remain in nominal charge.

The government has also announced plans for a more independent regulator of auditors. However, its measures stop short of an outright ban on non-audit work, leaving the decision to the new regulator. British auditors have taken to adding disclaimers to their opinions, saying, in effect, that only shareholders (not banks or other creditors) can rely on their work. The SEC is said to be considering prohibiting such weasel words from the accounts of British firms listed in America.

In German accounts, says Liesel Knorr, secretary-general of the German Accounting Standards Committee, “there is quite a bit of small-time cheating and there might be big cheating as well.” Because nobody checks, she says, you cannot tell. On a visit to the SEC in 1999, Hans Havermann, the committee's chairman, complained that German companies and their auditors were ignoring domestic standards. When the companies listed in America, he asked plaintively, could the SEC please try to get them to behave?

The SEC did its best. It refused to accept the accounts of Deutsche Bank before it listed on the New York Stock Exchange in 2001. It said that the way Deutsche treated some of its stakes in other companies disobeyed international accounting standards (IAS), which the bank claimed to follow. Rather than suffer the embarrassment of correcting its IAS figures, Deutsche listed in New York using America's generally accepted accounting principles (GAAP). In six European Union countries, there is no enforcement of accounting rules at all, says the European Federation of Accountants. Only Britain, France and Italy are thought to have effective scrutiny.

ET, the extra-territorial

The SEC's past experience of European accounting and auditing partly explains why the Sarbanes-Oxley act was extended to cover European companies listed in America and their auditors, to the annoyance of

European regulators, who grumble about extra-territorial laws. The European Commission is trying to soothe American worries. It wants EU countries to have national overseers of accounting standards and auditors by 2005, by when all listed European companies are meant to be using IAS. Besides Britain, so far Germany, Ireland and the Netherlands have made changes or announced plans.

The British think they stand a good chance of securing an exemption from the Sarbanes-Oxley act this year for their companies and auditors, because Britain's accounting and auditing regime is strong by European standards. The commission would prefer the EU to make its case as a block. But it could take years for the quality of, say, Italian and Greek auditing—judged poor by accountants farther north—to improve enough to satisfy the SEC.

One fix for auditing in Europe, thinks the commission, would be for all countries to apply the same audit rules, as devised by the International Auditing and Assurance Standards Board. However, experts on both sides of the Atlantic think these rules are too lax at the moment. “You could drive a Mack truck through them,” says Lynn Turner of Colorado State University, a former chief accountant of the SEC.

Reform cannot come too soon. Because international accounting standards are mostly tougher than the old national ones, companies will try harder than ever to find ways around them once they come into effect. Already, French and German banks are campaigning hard against a new standard on financial instruments. Unless there is proper oversight soon, says Ms Knorr, European accounts will in future be full of what she calls “IAS-lite”, meaning that they will pretend to obey international rules but in fact will not.

Behind all the prosaic initiatives for new rules and watchdogs lies a deeper struggle. American and European accountants are championing their respective sets of rules as the world's single accounting language. American GAAP is bound to lose importance in coming years, claims one European proponent of international rules. Soon, after all, some 7,000 European companies will be using IAS. But poor European enforcement and auditing, if it continues, may undermine the new standards. Unless Europe gets its act together, argues another fan of IAS, American accounting standards may win in the end.

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Economics focus

Chasing the leader

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Are Europeans really so much worse off than Americans?

AMERICA has been the world's economic leader for over a century. Economic theory suggests that western Europe should be catching up. Yet average GDP per head in the European Union, measured at purchasing-power parity, is only three-quarters of that in the United States. A popular explanation is that European firms are less productive because they are hampered by labour- and product-market regulation. But European productivity, measured by output per hour worked, has in fact almost caught up with America's. If Europeans are so productive, though, why are they apparently so much poorer than Americans?

America's much-trumpeted “productivity miracle” in the late 1990s created the misleading impression that Europe significantly lags America in the productivity league. It is true that, since 1995, American GDP per hour worked has risen by an annual average of 1.9%, compared with only 1.3% in the European Union. However, over any longer period, up to half a century, Europe's productivity growth has outpaced America's. Since 1990 American productivity has risen by 1.6% a year; the EU's has risen by 1.8%. Since 1950 America's productivity growth has averaged 2%, Europe's 3.3%. According to figures from the Conference Board, an American business group, Belgium, France, Germany, Ireland and the Netherlands all now boast higher output per hour than the United States. Average productivity in the EU is still 7% less, largely because of lower productivity in Britain, Spain, Greece and Portugal—but the gap has continued to close over the past decade.

The narrowing of the productivity gap has not, however, been reflected in living standards, as measured by GDP per head. The chart, taken from an analysis* by Robert Gordon, an economist at Northwestern University, shows how Europe's productivity and GDP per head fell relative to America's from the mid-19th century until around 1950. Productivity has since rebounded, almost reaching American levels. GDP per head, on the other hand, rose sharply until 1970, but then flattened off at 77% of America's.

The surge in Europe's productivity since 1950 is largely explained by reconstruction after the war and the belated exploitation of electricity and the mass production of cars—40 years after America. The puzzle is why Europe's GDP per head has lagged so far behind productivity. Germany's GDP per man-hour is 1% higher than in America, but its GDP per person is 25% lower. The main reason is that average hours worked in Europe have fallen so sharply. In part, this reflects an increase in unemployment and withdrawals from the labour force; but it also reflects a preference for shorter working weeks and longer holidays.

A broader analysis of living standards, based on economic welfare rather than crude GDP, argues Mr Gordon, would place some value on Europeans' greater leisure time. But how much of the depressing effect of shorter hours on Europe's GDP per head should be ascribed to people's free choice to take longer holidays than overworked Americans, and how much to union pressure or government policies that try to spread jobs by compulsory limits on hours of work? Mr Gordon guesses that one-third of the discrepancy between Europe's productivity and its GDP per head, relative to America's, represents freely chosen leisure. Corrected for this, Europe's income per head is not 77% (the official figure) but 82% of America's.

200 ways to say cheese

Mr Gordon does not stop there. After adjusting GDP per head for extra leisure time, he then attacks GDP itself. Mr Gordon argues that GDP comparisons tend to overstate America's living

standards and understate Europe's. For example, America's climate is more extreme than western Europe's, so more has to be spent on air conditioning and heating to attain a given indoor temperature. This extra spending boosts GDP, but does not enhance welfare. More of America's GDP is also spent on home and business security—largely because of a higher crime rate. In most of Europe, such spending is less necessary. The huge cost of keeping 2m people in American prisons (a far bigger proportion of the population than in Europe) also bolsters America's GDP relative to Europe's, but not its welfare.

Another factor is the greater dispersion of America's population in vast, sprawling metropolitan areas with few transport options other than the car. This is partly the result not of private choice but of public policy, such as subsidies to suburban motorways and a starving of public transport, or local zoning laws that limit the minimum size of residential developments. It leads to higher spending on roads and energy, and hence higher GDP. In Europe the convenience of more compact cities and frequent train and bus transport does not count towards GDP figures.

More contentious still, Mr Gordon suggests that we take account of the value that the French, say, place on variety. They protect small, local shops so that they can buy 200 kinds of cheese. Americans might retort that their gourmet supermarkets carry cheeses from all around the world, but Mr Gordon (an American, remember) argues that most Americans have to drive a long way to these stores and they exist only on the edge of big, well-off towns. GDP ignores such welfare comparisons.

Taking account of how Americans waste a chunk of their income on heating, air conditioning, prisons and the like, while also attaching value to Europe's superior public transport, Mr Gordon suggests that perhaps half of the current gap in living standards between America and Europe, as measured by GDP per head, is illusory. Add in the value of their extra leisure time and Europe's living standards are now perhaps only 8% behind America's, he suggests, not the 23% suggested by official data. Indeed, on Mr Gordon's broader measure, Europeans' productivity may have overtaken that of their poor American cousins.

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* "Two Centuries of Economic Growth: Europe Chasing the American Frontier". Available at http://faculty-web.at.northwestern.edu/economics/gordon/355.pdf

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The shuttle

And then there were three

Feb 6th 2003
From The Economist print edition

Of five shuttles built, only three remain. Where next for the shuttle, and for the future of manned spaceflight?

Get article background

IT SHOULD have been a perfect day. An exhaust plume was cutting a neat trail across the pale morning sky. All over America, people were watching the remarkable spacecraft zip across the continent, to its final destination on the eastern side of the country. Of course, as we now know, it never landed. In only a few seconds, another emblem of American hopes had disintegrated.

Most speculation about the cause of the accident centred on a piece of foam weighing 1.2kg (2.67lb) that dinged the trailing edge of *Columbia*'s wing during take-off. Precisely how this may have led *Columbia* to start shedding heat-protective tiles, and then to break apart, is the leading line of inquiry. Why were the first sensors to show a rise in temperature those in the left wheel wells? Why did the trailing edge of the wing show problems before its leading edge? Only a detailed analysis of the tens of thousands of fragments of debris that are now scattered over 1.8m square km (700,000 square miles) will yield anything close to conclusive answers. For now, the world must wait.

Could the astronauts have been saved had the damage been noticed sooner? Probably not. It is unlikely that a rescue mission involving another shuttle could have been prepared in time. Audiences fed on a diet of science fiction are used to astronauts hopping into waiting spacecraft. Preparing a shuttle for flight requires about 1.2m separate procedures. So the shuttle may have been doomed from the moment of take-off. Others, though, say it was doomed a lot earlier than that.

Fields of greenbacks

Hindsight is a wonderful thing. Three main kinds of criticism were instantly expressed concerning the real cause of the disaster: massive budget cuts, ignored safety warnings and the age of the shuttle. Each of these is simplistic.

After any accident, it is not difficult to find somebody who has complained of a lack of funding. Talk of a shortage of money, and even of 40% cuts, is particularly imaginative, however. One way of arriving at this figure is by comparing what NASA, America's space agency, spent when funding was at its height (during the Apollo-era race for the moon) with today. But it does not follow that anything has been “cut” from the shuttle programme.

Unless, that is, one looks at a recent NASA document on two decades of shuttle operation. In it, NASA says that over the past ten years it has saved the taxpayer billions of dollars by improving efficiency and safety. The costs of launching a shuttle have dropped by about 40%, while the time to prepare a mission has been shortened by a third. But improvements in efficiency are not cuts. The real question is: did some of this saving come from an over-enthusiastic trimming of staff? Until further details of the accident are known, it is not possible to say whether a lack of staff may have contributed to the accident—though it seems unlikely.

Roger Pielke, director of the Centre for Science and Technology Policy Research at the University of Colorado, Boulder, says that Congress has provided NASA with more funding than it requested for the shuttle programme throughout its 31-year history. Dr Pielke adds that the American people have shown tremendous support for manned spaceflight, investing hundreds of billions of dollars over four decades. This strong support—at around $7 billion a year—is expected to continue.

Should NASA have been asking for more money for its manned spaceflight programmes? Hardly. NASA's problem has never been a shortage of cash but rather an inability to keep a tight rein on what it has received. It has a sorry history of late, oversold and over-budget missions. NASA's accounting problems came to a head last year, when it was found that poor budgeting had left the agency with a $5 billion shortfall. Only then did the government, tired of such problems, refuse to bail the agency out. President Bush appointed Sean O'Keefe, from the Office of Management and Budget, as NASA's new administrator, to get a firmer grip.

Another criticism is that NASA ignored safety concerns. Again, after any big accident, one can find people who say they were worried about safety, or even claim to have been sacked for raising concerns. But it is hard to believe their senior bosses would deliberately ignore legitimate safety concerns. NASA's deputy administrator and chief operating officer, Frederick Gregory, is an ex-astronaut who has spent 455 hours in space. Is it likely that ex-astronauts and air-force pilots would willingly ignore shuttle safety? One NASA spokesperson, speaking “personally”, comments that “to say that senior officials ignored safety warnings...I hesitate to use the word libellous or slanderous, but that really does offend us.”

The problem is that in any endeavour of this scale and complexity, there will be differences of opinion over safety risks. Once again, only more information about the accident will reveal whether legitimate long-term issues were overlooked. And such opinions will have to be squared with a broader view of the shuttle, which NASA says has become safer. In the past two decades, the number of recorded in-flight shuttle problems has dropped by 70%, even as flights have become heavier and more complex.

Was *Columbia* simply too old to fly? No. Shuttles are rebuilt almost completely after each flight. Many of the parts that are not, such as the frame, are designed for more than 100 flights. (*Columbia*, the oldest shuttle, had flown only 28.) The remaining bits are refurbished periodically, as had been done recently for *Columbia*. In fact, a recent review had decided that, with new investment, the shuttle could fly until 2020, and perhaps beyond.

After the shuttle

The real issues, and the focus for the House of Representatives' Committee on Science and other congressional overseers, are slightly different. One is that, if NASA relies on the shuttle until at least 2020, and another accident happens, how can it then gain access to the International Space Station? There are no plans to use Russia's *Soyuz*, the other way of getting there, beyond 2006. Another issue is that, as the shuttle gets older, maintaining current safety levels will cost more than NASA looks likely to get.

Last November, NASA decided to release some cash by ending expensive plans to build a new and fully reusable craft to replace the shuttle by 2012. But the project, known as the Space Launch Initiative, would have ultimately required a lot more cash than this. The programme had been hailed as the future for more reliable and affordable access to space. Yet the shuttle was also promised to cut launch costs but did the reverse. The new goal of reducing launch costs to $1,000 per pound is highly optimistic.

Reuters

The problem, as even the most gung-ho space enthusiasts agree, is that reusable spacecraft do not yet make economic sense. A fully reusable craft is difficult to justify unless it can be flown more than 50 times a year. (The shuttle only manages five to six flights a year.) Over the next two decades, global demand for launches is expected to run at less than this, somewhere between 30-40 shuttle equivalents a year. But launch services for this market are already over-supplied.

Antonio Elias, vice-president of advanced programmes at Orbital Sciences Corporation, a commercial-satellite company based in Dulles, Virginia, said recently that the economic rate for reusable vehicles had not changed for decades. This is because the two fundamental parameters of rocketry—the efficiency of rocket engines and the properties of structural materials—have not changed. It is difficult to see how investing in any spacecraft that could take 25 years to pay back its development costs can be justified. In the next few decades, the only reusable “space” vehicles that are likely to make sense are those being designed and built by private industry to take tourists 100km (about ten times higher than an airliner) above the earth.

So what vehicle should follow the shuttle? One school of thought argues that NASA should return to tried and tested (cheap) expendable launch vehicles for manned spaceflight: use them once, then throw them away. It may not be very “Star Trek” to see astronauts parachuting back to earth in a cramped capsule, but it is much cheaper. The second camp argues that, as reusables are “the future”, anybody with any vision should be building them immediately. (The current shuttle is only partially reusable.)

NASA's decision to cancel the Space Launch Initiative, and build what it calls the Orbital Space Plane (OSP), was a compromise that pleased few people. The OSP will be part reusable, part expendable. The plane itself will be reusable, but it will launch atop expendable rockets. This is old technology that is tried and tested, so it is expected to be reliable. There are doubts, though, about whether the new space plane will arrive soon enough. Are there any other options?

Was it over already?

The Russians are coming

The space plane is meant to transport crew to the space station, and to act as a lifeboat. At the moment the station's lifeboat is a three-man *Soyuz* capsule that is replaced every six months when new crew are delivered. Russian craft also deliver supplies to the station. Some think that the Russians could play a larger role in servicing the space station.

It is an attractive option. The Russians charge only $60m for a *Soyuz* launch, compared with the roughly $500m it costs to launch a shuttle. One problem, though, is that any order now would take more than two years to deliver. And even that assumes that the Russian government could impose some budgetary order on cash that has in the past mysteriously vanished before arriving in the bank accounts of Energia, the company that builds the *Soyuz* and the Proton rockets that launch it.

The Russians alone cannot save the space station

Even a moderate injection of cash—say $150m (about the size of the entire Russian space budget)—could transform a programme which is running down in anticipation of its money expiring in 2006. But there are two other reasons why the Russians alone cannot save the space station. Even though it is called the international space station, many in America fret about leaving access exclusively in the hands of the Russians. The other is that, if further construction work is to be done, there is only one vehicle on earth that can haul the largest pieces of the station up into orbit: the shuttle.

What else might work? Although some limited outsourcing has been done, full privatisation is not possible, according to a recent report for RAND, a think-tank based in Santa Monica, California. Who would want to buy it, they ask? Another RAND suggestion is to hive the shuttle into a “space transit authority”, thus getting NASA out of the business of space flight altogether and allowing it to focus on science and technology.

Other options for replacing the shuttle are sketchier still. NASA could co-operate with defence interests in developing a replacement. Or an unmanned, and thus cheaper, shuttle could take large pieces of the station into orbit, while people could reach the station on expendable craft. These are all unlikely ideas, though the latter might be considered further.

Is the shuttle heading for more problems? Only if America decides it has had enough of manned spaceflight and wants to abandon the space station. For there is no point in one without the other: each part being equally pointless on its own, their fates are irretrievably intertwined. So the station is the reason that the shuttle will fly even after the next accident.

After *Challenger* in 1986, NASA had the luxury of time. It grounded the shuttle for 32 months, as it hunted down the problem that had caused the disaster. Today, the demands of keeping the station operational make any long delay unlikely.

Where next?

On the day of the accident, the world was told that the astronauts believed in what they were doing. In the face of such a catastrophic loss, it seems harsh to make the point that not everybody agrees that people should be up in space at all.

This observation should not detract from the bravery and talent of the crew. But neither should the loss stifle legitimate questions about why we are in space, and how we should explore it. In September last year, a writer for the *Orlando Sentinel* summed it up, by saying of the space station, “It's too bad we can't crash the thing into the ocean, throw the shuttles in after it, and redirect those billions to more pertinent research.”

At present, NASA spends the lion's share of its $15 billion annual budget on manned spaceflight. Should it? There are two main reasons why spaceniks will tell you this is a good idea: because of all the science done on the space station and the shuttle, and because they are important for the exploration of space. Both arguments are misleading.

Mir had little to show for its 15 years in orbit

Most egregious is the fig-leaf of science that has, over the years, been meticulously arranged over the shuttle and the space station. The work of humans in space, says Bob Park, a physicist at the University of Maryland, has had practically no impact on science. Thus *Mir*, the previous space station, had little to show for its 15 years in orbit. One study found that plants did not grow well in space. Later it was realised that this had nothing to do with microgravity. The plants had been stunted by a well-known effect: they release a gas called ethylene, which had accumulated in *Mir*'s enclosed structure. The American Society for Cell Biology called the international space station the most expensive and inflexible research laboratory ever built.

It is not popular to say that much of the research done in space is better done in terrestrial laboratories. Experiments requiring microgravity can be done on cheap unmanned rockets with no risk to human life. In fact, Andrew Coates, from the Mullard Space Science Laboratory at University College London, argues that microgravity research on the space station is a positively bad idea. The station is a big throbbing structure with human occupants rattling around in it, and this distorts any results.

As for the spaceniks' second argument—that manned spaceflight is needed to do research into the damaging effects of microgravity on the human body—it is essentially circular. It boils down to saying that we have to put people into space so that they can study the effect of space on people. If a visit to Mars were on the cards, such research might be useful one day—but for now there is no sign of such a plan.

Humbling though it may be, for the present people are unnecessary for space science, and they are also an expensive liability. Telescopes, earth-observing satellites, global positioning systems, communications and spy satellites all work perfectly well without human involvement. Even in the rarest cases of experiments that require human involvement in space, it is tough to find enough science to justify a $100 billion platform, or even a single $500m shuttle.

As for exploration, Dr Coates points out that, besides the moon programme, which grew out of the cold war, the only exploration mankind has managed in space is to send a few hundred people 400km above the earth. This is about the distance between London and Edinburgh: not very impressive. Robots and probes, in contrast, have explored nearly all the planets in the solar system, visited comets and looked deeply into the universe. We need to put man's place in the universe into the overall scheme of things, he urges.

So why are we still there? The technology to do more than briefly visit the moon or Mars does not yet exist. Further ahead, mankind will have a place and a purpose in space, but until technology improves, manned spaceflight will be an expensive luxury. NASA could focus on getting the costs of spaceflight down, and on helping the private sector to get tourists on sub-orbital flights. Any money saved could be used on the more pressing questions of space science: are we alone in the universe, is there life on Mars, could we live there, are there other earth-like planets, where did we come from? In the short term, robots and instruments should tackle these questions. There will be many spin-off benefits that arise from this research in the field of miniaturisation and robotics.

If, later this year, China launches its first astronauts into space, calls to beef up America's manned-spaceflight programme are bound to increase. That would risk missing the real frontier in space over the next couple of decades. This other frontier is not a place, but rather a matter of knowledge. Robots could approach and extend it farther than people could—and at far lower cost, however you measure it.

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The Richard Casement internship

Feb 6th 2003
From The Economist print edition

We invite applications for the 2003 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 24th. They should be sent by e-mail to casement@economist.com

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About sponsorship

Modern Europe

Life in the old continent yet

Feb 6th 2003
From The Economist print edition

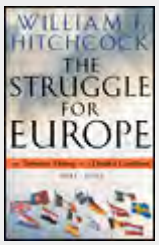
Alamy

An unfashionably optimistic history of Europe from across the Atlantic

EUROPE, viewed from across the Atlantic, is often looked on as a depressing place—not so much the old continent as the dark continent: economically stuck, politically and morally confused, militarily feeble and populated most visibly by pensioners, trade-unionists, anti-Semites and terrorists.

William Hitchcock's splendid new history of post-war Europe is a corrective to this dismal picture. By looking at how much Europe has achieved over the past 50 years he is able to take a view of the continent that is fundamentally—and appropriately—optimistic. Starting his narrative with a compelling portrait of a wrecked and divided continent in 1945, he makes clear that the dominant themes of the next half century were the establishment of peace, remarkable economic recovery and an ultimately successful struggle against communism. The fact that this comprehensive and nuanced history should be the work of an American historian (currently a professor at Wellesley College) is also worth remembering in a time of transatlantic tension. The embittered rants of Europe's Americaphobes and America's Europe-bashers make good newspaper copy—and feed off each other—so it is important to be reminded that there is a deep fund of mutual knowledge and sympathy on both sides of the Atlantic.

The Struggle for Europe: The Turbulent History of a Divided Continent 1945-2002
By William I. Hitchcock



Doubleday; 513 pages; $35.
Profile Books; £25

Buy it at
Amazon.com
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Long survey histories, covering 50 years and numerous countries, can be difficult books both to write and to read. For anyone unfamiliar with the period they risk turning into a blizzard of undifferentiated facts. For the *cognoscenti*, there is a danger that they will simply be a rehearsal of well-known events, without adding anything really new. Mr Hitchcock is careful to avoid both pitfalls. He finds a convincing pattern in his material by imposing four themes on his chronology: the aftermath of war; economic boom in the 1950s and 1960s; rebellion in the 1960s and 1970s, covering everything from the Red Brigades in Italy to the democratic revolutions in Spain and Portugal; and unity for the last two decades of the century, covering the fall of communism and the deepening of European integration.

More important, he is a gifted storyteller, with a knack for choosing the right anecdote and quotation to enliven his story. Well-known parts of the tale are complemented by less familiar material. Churchill's “iron curtain” speech is there; but so is Marshall Zhukov's chilling exhortation to Russian troops entering Germany: “We shall avenge those burned in the devil's ovens, avenge those who suffocated in the gas

chambers, avenge the murdered and the martyred. We shall exact a brutal revenge for everything." Just as evocative is Norman Lewis's description of Naples in 1943—"this city so shattered, so starved, so deprived of all those things that justify a city's existence...There is little food, water, no salt, no soap. A lot of Neapolitans have lost their possessions, including most of their clothing..."

As with most survey histories, it is possible to dip in and out of sections of Mr Hitchcock's book—to read the chapters on European integration, for example, but to skip those on decolonisation or the Soviet Union. But the reader who adopts this strategy would be missing something. It is part of the skill of the book that each section throws a light on the others. France's post-war embrace of Germany and European political integration, makes much more sense when understood against the backdrop of the debacle of decolonisation in Algeria and Indochina in the 1950s. The determination and energy with which the Germans set about creating their economic miracle is better understood against the background of the grim events on the other side of the iron curtain.

Although "The Struggle for Europe" tells a fundamentally optimistic story, it is not blindly upbeat. Mr Hitchcock ends his narrative by focusing on two of the more difficult issues facing Europe: the question of "who is European", which is part of the struggle to deal with mass immigration, and the simultaneously dynamic and tortured efforts to create a European Union, while maintaining the democratic legitimacy of the enterprise. These are formidable challenges. But as "The Struggle for Europe" makes clear, the continent has come through worse over the past 50 years.

The Struggle for Europe: The Turbulent History of a Divided Continent 1945-2002.
By William I. Hitchcock.
Doubleday; 513 pages; $35.
Profile Books; £25

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About sponsorship

New verse

Reasons for rhyme

Feb 6th 2003
From The Economist print edition

Modern poetry can be plaintive or richly idiomatic, or both

MOST intellectually ambitious contemporary poetry inclines to the abstract. The words please themselves. They are non-representational, or less representational—there as paint rather than likeness; squeak or drone or rattle rather than melody. Such venerable stand-bys as lyrical states of feeling, description or narrative are, if not absent, then complicated or mangled. For the reader, it can appear a bumpy and unenticing prospect. But then, we are not talking about a popular art.

This is true even of someone like Paul Muldoon—born in 1951 in Armagh but based for the past 15 years in America, and currently professor of poetry at the University of Oxford—who is certainly one of the most beguiling and delightful of writers. His latest book, the ninth, is about deracination and reorientation, the move, as he puts it with the emblematic adspeak so characteristic of this volume, from “theOrchard County” to “the Garden State”.

The “Moy” of the title is Mr Muldoon's native village; having acquired Jewish in-laws, he casts himself unforgettably as “the goy from the Moy”. A representative poem called “The Ancestor” offers a comedy of miscegenation, of the inauthentic, of living among the garage-sale heirlooms of others: “The great-grandmother who bears down on us, as if beholding the mote/in our eye, from a nineteenth century Hungarian portrait/on our library wall is no relation. Not even remote.”

And yet, self-expression is about the last thing a Muldoon poem is for. The man is a maker and finder of patterns. It begins with an authentically personal grammar; as T.S. Eliot is founded on rhythm, so certain constructions and tenses—even the pluperfect—are Muldoon. These then find issuance in rhyme, of which Mr Muldoon is the outstanding contemporary practitioner. Rhyme not as convention or swank, but as the expression of a naturally crystallising imagination. The effect is of a great web of connections, a cracking glaze which seems to run ahead of you as you read.

There is a sort of meeting of opposites between Mr Muldoon's pointed, intricate prestidigitations and the aimless yet alert shamblings of the veteran New York School poet, John Ashbery. The one you read on the edge of your saddle, the other in a more horizontally appreciative posture—but still they don't seem entirely incompatible. Mr Muldoon may be a conspiracy theorist of language—all rhymers are—while Mr Ashbery wears a benign grin, but both wander the same streets.

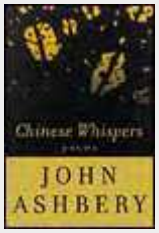
If Mr Muldoon has an eye for a construction, Mr Ashbery has an ear for speech—no one more so. To read a poem of his is to wander round not a museum, but a waxwork of language, encountering “'sblood”, “He had a passion for straw marquetry”, “Sometimes dyslexia strikes in late middle age.” It doesn't do to press or hope for too much from these poems, but taken slowly, and with a disengaged mind, their weird and wonderful idioms and loosely fitting nouns exert a kind of passive fascination. The ideal Ashbery reader is a foreigner or an extra-terrestrial: there can be no more liberating way of learning English than

Moy Sand and Gravel
By Paul Muldoon

Farrar, Straus and Giroux; 120 pages; $22.
Faber and Faber; £14.99

Buy it at
Amazon.com
Amazon.co.uk

Chinese Whispers
By John Ashbery



Farrar, Straus and Giroux; 112 pages; $22.
Carcanet Press; £9.95

Buy it at
Amazon.com
Amazon.co.uk

The Unswept Room
By Sharon Olds

Knopf; 96 pages; $25.
Jonathan Cape; £8

Buy it at
Amazon.com

from these wacky, dandified samplings.

Amazon.co.uk

At the other end of the spectrum from both Mr Ashbery and Mr Muldoon is someone like Sharon Olds, who writes poetry of sheer, unreconstructed pathos that is not so much autobiographical as autobiological—about herself from the neck down. She takes Larkin's “This Be the Verse,” and seems to apply it to herself: as it were, “they fucked me up, my mum and dad”. This is the drab, barely expressed misery that one finds in a lot of contemporary poetry—Ms Olds is quite as influential in her way as Mr Muldoon or Mr Ashbery. To vary Wilfred Owen, the poetry is in the self-pity. It may well be that Ms Olds's is the sound of a particular voice in contemporary America, one that is at once plaintive, self-righteous and high-toned. But only rarely—across the odd word or line—does it approach the conciseness or memorableness of poetry.

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By Paul Muldoon.
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New fiction

Killer kindness

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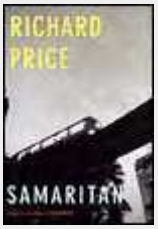
From The Economist print edition

RAY MITCHELL, the hero of Richard Price's seventh novel, desperately wants to do good. But doing good isn't doing him any good. A couple of chapters into the action, Ray's head has been smashed in with a vase and he is fighting for his life in hospital.

Nerese Ammons, a childhood acquaintance of Ray's and now a police detective, vows to bring his attacker to book. But she immediately runs into an unexpected problem. Ray will not say who did it, or why.

So the suspense builds slowly, as Nerese, a little ploddingly, works these things out herself. As well as being a novelist, Mr Price is also a Hollywood screenwriter ("The Color of Money", "Sea of Love", "Ransom"), and it shows. There is no faulting his jazzy sense of rhythm or his ability to interweave separate story lines.

Samaritan
By Richard Price



Knopf; 377 pages; $25.
Bloomsbury; £12.99

Buy it at
Amazon.com
Amazon.co.uk

It turns out that Ray has a chequered past, with stints as a high school teacher, a taxi driver and a polygrapher. More recently, a stroke of improbably good luck took him from New York to Los Angeles, where he became a writer for a popular TV programme. But this late success hasn't dulled the memory of his wasted years as a cocaine addict or of his ruined marriage.

Hence his rebirth as a do-gooder. Having returned to the east coast, drug-free and with money in the bank, Ray busies himself with helping other people out in order to impress them: his pupils, his estranged teenage daughter, his new girlfriend. The only one blind to the possible pitfalls of Ray's Good Samaritan lark is Ray himself.

"Samaritan" is set in the same fictional New Jersey town as two of Mr Price's previous novels, "Clockers" and "Freedomland", with its grotty high-rise apartment buildings, boarded-up crackhouses and trains clattering along elevated railway tracks. Mr Price is able to bring all this to life in a snippet of conversation (the dialogue is, line by line, terrific) or just a phrase, as when Nerese remembers a prostitute working outside a hospital, "wearing nothing but shorty pyjamas, platform shoes and a copper wig, the part in which slowly revolved like a nocturnal sundial hour after hour as she made her way in and out of the back seats of cars."

Samaritan.
By Richard Price.
Knopf; 377 pages; $25.
Bloomsbury; £12.99

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Titian on show

Struggle for a space

Feb 6th 2003
From The Economist print edition

Gathering together the masterpieces for the National Gallery's new Titian show has been a diplomatic headache

National Gallery

Send us your Bacchanals to worship

THE Titian exhibition that opens at the National Gallery in London later this month, and travels on to the Prado in Madrid in June, has been over three years in the making. As well as patience, it has taken scholarship and brinkmanship. And while the diplomatic persuasion did not stretch to bending fingers or biting ears, as in Titian's "The Worship of Venus" (right), it has, at times, come almost to that.

More than 300,000 people are expected to visit each of the shows and both museums are playing to their strengths. The Prado, which has the world's biggest collection of Titians, describes its offering as the first major retrospective of the artist since the 1935 exhibition in Venice. Some people will recall that there have been at least four major Titian exhibitions in the past 20 years, but the Prado, long a generous lender of pictures to other museums, wants to be a major player in the world of international blockbuster shows and is signalling a muscular new pushiness. "The Prado has not taken as much advantage as it might have done from its lending," says Gabriele Finaldi, the deputy director. "We shall be reminding people of how generous we have been in the past."

The National Gallery's show, which will feature Titians of all the major periods, has a different focus: the reconstruction, after more than 400 years, of one of the *camerini d'alabastro*, the private rooms that Alfonso d'Este, Duke of Ferrara, built for himself in the early 16th century, one to house paintings and the other sculpture. A famous war captain married to Lucrezia Borgia, Alfonso was an enthusiastic lover of art, who visited Michelangelo while he painted the ceiling of the Sistine Chapel to beg for a painting. In 1513 he commissioned Giovanni Bellini to paint him a "Feast of the Gods" for his new gallery. Dosso Dossi finished ten oblong canvases depicting scenes from Virgil's *Aeneid* for a frieze that would run around the top of the room. Raphael worked on a "Triumph of Bacchus" and more than 30 marble sculptures were ordered.

The heart of the *camerino* with the paintings was the three mythological scenes painted by Titian. The Venetian master's rich solid landscapes together with his figures with their softly spun hair and creamy flesh, their billowing draperies so confident you can almost feel the contrast of cotton and silk, all help to illustrate the extent to which Titian, more than any painter before him, had coined a way of bringing ancient literature to life. By the time Titian came to paint over the landscape in Bellini's early work for the *camerino*, Alfonso d'Este's chamber was no longer a gallery of different great artists, but had become Titian's own room. In 1598, when the pope reasserted his rights over Ferrara, and the *camerini* were stripped, it was the Titians that his nephew, Cardinal Pietro Aldobrandini, longed for most of all.

Reconstructing the *camerino* has long been an ambition for the National Gallery, the Prado and the National Gallery of Art in Washington, all of which own at least one painting that once hung in the room. Which of them would succeed? Until recently, none could have managed it. No contemporary eyewitness account of the room exists. Virtually nothing was known about its measurements, how it was decorated, how many windows it had or even precisely where it was located. Charles Hope, the director of the Warburg Institute, has been scouring Italian archives for records of the *camerini* ever since he was a fledgling art historian in his 20s. In 1965, an inventory was found in the Museo del Risorgimento, which showed that the private ducal quarters were made up of five rooms, including the *camerini*. In 2001, another inventory was found in the state archives in Ferrara. Whoever drew it up had clearly not been

allowed into the rooms, but was nevertheless able to provide more information: although the details of how the pictures were hung had been known for some time, the new inventory confirmed the existence of a sixth room, together with more about the location of the *camerini* in the Via Coperta and some of their measurements.

Split canvases

Armed with these details, Mr Hope and the curators of the National Gallery have made a simulated video reconstruction of what the room might have looked like. But recreating the *camerini* also meant reuniting the three Titians, now split between London and Madrid, with Bellini's masterpiece, one of the two most important Renaissance paintings in America. The four Dosso Dossis that exist would have to come from Birmingham, Ottawa and a private collection in New York, and the sculpted reliefs from St Petersburg, where they are in the Hermitage museum.

The National Gallery's “Bacchus and Ariadne” turned out to be the most fragile of all the pictures, so if anyone were to recreate the *camerino* it would have to be London. But would the others co-operate? That was the single most important question facing the National Gallery, says David Jaffé, the ebullient curator of Renaissance painting, whose unflagging enthusiasm has been largely responsible for making the dream a reality.

At its conception, the exhibition was going to be just another Titian show. The National Gallery's early Titians neatly complement the Prado's massive collection of the master's later works. Each museum would temporarily lend the other six of its pictures to round out the two collections. At the time, the National Gallery wasn't even thinking of the *camerini* and the Prado had its eye on a different Titian exhibition altogether, with the Kunsthistorisches Museum in Vienna. The aim of that show was to help settle the debate over whether the freewheeling painting style of some of Titian's later works is Titian simplifying the thick complex strokes of his early paintings or whether these pictures simply remained unfinished at his death, only to be completed, in some cases, by surviving members of his studio.

Sylvia Ferino-Pagden, the curator of Italian Renaissance paintings at the Vienna gallery, had established a close working relationship with Fernando Checa, then head of the Prado, and negotiations between the two museums were fairly advanced. “We had a concrete list of the items we wanted [to borrow] and we had exchanged letters of intent,” she confirms. However, Mr Checa's sudden forced resignation in November 2001 put paid to those plans. Within weeks of taking over, his successor, Miguel Zagaza, made it plain that his first new dancing partner would be London rather than Vienna. “It is a very great pity,” says Ms Ferino-Pagden, who refused the National Gallery's request to borrow the famous “Nymph and Shepherd”, the one with five arms, as it is being restored. “That will be the centrepiece of *our* exhibition in 2007,” she says firmly.

Hard to get

Early requests to other museums proved less difficult. Palazzo Pitti in Florence agreed to send its portrait of Titian's friend Pietro Aretino and Berlin's Gemäldegalerie its beguiling picture of the bejewelled two-year-old Clarissa Strozzi with her dog as well as the self-portrait Titian painted when he was an old man.

But others quickly began playing hardball. The Duke of Sutherland, whose Titians are on public display in Edinburgh, would not agree to send one to London until Mr Jaffé found him a letter, written in August 1839 by a Lord Francis Egerton, one of the duke's ancestors, in which he promises the National Gallery, of which he was then a trustee, that it could keep his Titians “with perfect convenience as long as you please”. The Museo di Capodimonte in Naples would send its “Danaë”, but only if it could borrow Velazquez's magnificent “Rokeby Venus” in return. The archbishop of Kromeriz had to be persuaded by the archbishops of both Prague and Madrid to lend “The Flaying of Marsyas”, but insisted the National Gallery provide a laser reproduction to cover up the hole the loan would create.

National Gallery/Museo nacional del Prado, Madrid

...and your tears

The Prado too would not be pushed. Having at first promised that it would lend its “Danaë” and one of the two Bacchanals from the *camerino*, it balked when London asked

for the second. If it wanted both, the Prado insisted, the National Gallery would have to lend a Manet for a show that opens later this year and give up the “Danaë”, which, the Madrid museum wanted, in any case, to send to Holland in return for borrowing a Vermeer.

By Christmas 2002, the National Gallery was still waiting to hear from Washington about the prize—Bellini's “The Feast of the Gods”. Without it, the dream of recreating the *camerino* would be ruined. David Allen Brown, the curator of Renaissance pictures at the National Gallery in Washington, had at first told Mr Jaffé the museum would not even consider lending the picture. Last autumn, the director, Earl “Rusty” Powell, wrote, saying it might consider the loan if the Prado lent its two Bacchanals. In November, Washington explained that it was only able to lend 12 pictures from its founding collections at any one time, and that the limit had already been reached. Mr Jaffé responded, saying that if it helped he would give up the portrait of Ranuccio Farnese (which would have infuriated the marketing department as that picture had already been chosen for some of the posters exhibiting the show). The catalogue for the exhibition went to the printer, with two pages held open until Washington's decision was known. It was only on December 30th, at a special meeting convened by conference call, that the trustees finally agreed that “The Feast of the Gods” could travel to London, though not to the Prado.

Despite that, the new year brought fresh problems. The Hermitage, which wanted the National Gallery to lend Tintoretto's “The Origin of the Milky Way” as well as sending trucks and fuel to collect two of the *camerino* statues, finally decided they were too fragile to travel, despite the fact that the Russians were still promising to send 30 of the statues to Ferrara in September. At the last minute, they also changed their minds about sending their “Saint Sebastian”. And on January 30th, less than two days before the National Gallery began hanging the show, the trustees of the Villa Borghese gallery in Rome sent word that they also would not send “Sacred and Profane Love”, Titian's enigmatic masterpiece from 1514. The director of the National Gallery, Charles Saumarez Smith, wrote the same day to the Italian ambassador begging the government to reconsider and Mr Jaffé flew to Rome to make his plea in person.

The Italians' decision not to lend the painting recalls an occasion in 1930 when Mussolini himself wanted to despatch it to London to promote the greatness of what he called *l'italianità*. The guardians of the Villa Borghese refused, explaining “*che ne abbiamo uno solo*”, “we have only a single example of it.” Each of Titian's paintings is unique and his influence was enormous. It is easy to forget that there is much to be learned in occasionally seeing his paintings grouped together, and even more when they are shown alongside other artists he inspired. “It is vital to place different artists side by side,” explains Mr Jaffé. “You can hear one artist talking to the other, asking him questions. It's a conversation. Picasso and Matisse, Titian and Rubens. It's a love affair. They talk.” If it takes patience, diplomacy and force of will to ensure that those conversations continue down the ages, then that surely is worth the effort.

“Titian”: at the National Gallery, London, from February 19th-May 18th, and at the Prado Museum, Madrid, from June 9th-September 7th. Catalogue published by National Gallery Company; £10

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The Columbia seven

Feb 6th 2003
From The Economist print edition

AP

Columbia's crew of seven died on February 1st

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THE space shuttle *Columbia* took off on its last flight without particular ceremony. Shuttles have been America's space workhorses for more than 20 years. They are regularly rocketed into space loaded with satellites, or supplies for a space station, or boxes of plants to see how they grow without gravity; that sort of thing. Yet, humdrum or not, getting a ride in a shuttle, joining the still tiny group of people who have viewed the world from the heavens like gods, is greatly coveted. All seven in *Columbia*'s crew had served long apprenticeships in more earthbound activities before being considered for a space trip. All seven were in their 40s; the five men with receding hairlines; the two women doing their best to look alluring in their working clothes. No movie director would have cast them for a space epic. Yet each had a personality more interesting than that suggested by the routine grins offered to cameramen.

Kalpana Chawla, an Indian-born naturalised American, had for years radiated star quality, particularly in Karnal, the small farming town in northern India where she grew up. She said that J.R.D. Tata, who flew the first mail flights in India, had been her childhood hero. The *Times of India* and *India Today*, a news magazine, ran pictures of Miss Chawla as she prepared for her mission. Readers were told when to watch the skies of southern India as *Columbia* passed over in orbit during the 16-day journey.

Miss Chawla had had an earlier trip into space in 1997 after studying aerospace engineering in India and America, and learning to pilot practically anything that could fly, from gliders to airliners. For Indian politicians her career has for years been an argument that technology promised a hopeful future for all Indians, a powerful message in a country where millions live in poverty. When technology failed Kalpana Chawla last weekend, Karnal turned to its old, trusted ways. Incense was burnt and marigolds were placed on her photographs.

The symbols

The United States turned to its own trusted symbol, the flag. All over the country flags were lowered to half-mast. Israel did the same. Ilan Ramon, an Israeli air force colonel, was the only non-American in the crew. In the aftermath of the shuttle disaster, Israel, perhaps understandably, sought to emphasise its links with the United States. Ariel Sharon, the Israeli prime minister, said that “at times like these” the two countries felt their “common fate, identity and values, and shared vision”. Just as Indian newspapers

had dwelt on Miss Chawla's qualities as a symbol of the new India, the Israeli press recounted Mr Ramon's exploits in defence of his country. In 1981 he had taken part in an air attack on a nuclear reactor being built in Iraq. He was a modest soldier. “There was no knife between his teeth,” said a colleague. Mr Ramon recalled that an Arab, Sultan bin Salman of Saudi Arabia, had flown in a space shuttle in 1985, so he was not the first astronaut from the Middle East. As well as Israel, he represented “all our neighbours”.

Mr Ramon was one of a number of foreigners who have been invited from time to time to take part in shuttle flights. He had been training with the rest of the crew since July 1998. As *Columbia's*“payload specialist” he had the most peaceful of the 59 scientific tasks being carried out: studying the effects of sandstorms on climate.

Three of the Americans in *Columbia* were on their first space flights. Laurel Clark was a physician and much of her previous experience had been in submarines, where she worked on escape techniques. The day before the shuttle burnt up, she sent to her family an e-mail, now a footnote in space history, describing the trip. David Brown was another doctor. As a young man he worked in a circus as an acrobat. He said it taught him the value of team work. William McCool, the pilot of the shuttle, was a former test pilot. Rick Husband, the shuttle's commander, was on his second space flight. He was working with a team designing spacecraft for possible trips to the moon and beyond.

This was the first shuttle mission for three years to be given over entirely to scientific experiments, rather than as a space truck carrying cargoes to a space station being assembled 200 miles above the earth. Michael Anderson, an African-American, had the job of checking that all the experiments were going well. He, like Miss Chawla and Mr Ramon, was aware that he carried an extra burden in his job: as a role model for young blacks. Impressively, he had logged more than 200 hours in space. One of his trips was to *Mir*, a Russian station that has since been abandoned after years in space.

It is obvious to say that the seven made a unified group. If you work together towards a common objective over a period of several years there is likely to be a unity. But for the *Columbia* seven there was more than that. Some people call themselves Europeans, some Asians, some indeed Americans. Kalpana Chawla said, “When you are in space and look at the stars and the galaxy, you feel that you are not just from any particular piece of land, but from the solar system.”

In the picture: from left, Chawla, McCool, Ramon, Husband, Clark, Anderson, Brown.

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Overview

Feb 6th 2003
From The Economist print edition

Even though war looms, **America's** latest economic data have been encouraging. American factories reported that orders rose by 0.4% in December, after a 0.8% decline in November. The Institute of Supply Management (ISM) manufacturing index fell from 55.2 in December to 53.9 in January, but its new-orders component remained strong. The ISM's services index rose to 54.5 in January. (ISM readings above 50 indicate expansion, those below 50 contraction.)

Unemployment in **Japan** rose to 5.5% in November, matching the country's post-war record. Those who still have jobs are taking home thinner pay packets: in the 12 months to December, average wages fell by 1.9%, even more than the 0.3% drop in consumer prices.

Despite weak economic growth, the **euro area's** unemployment rate was unchanged in December, at 8.5%. In Germany, however, unemployment climbed to 10.3% of its labour force on its national definition, or to 8.6% as measured according to the EU's harmonised rate. Consumer-price inflation in the euro area fell by more than expected, from 2.3% in December to 2.1% in January.

War jitters sent **gold** prices climbing to nearly $390 an ounce, a level not seen since 1996. **Platinum** briefly touched a new 23-year high of $705 an ounce. Government-bond prices also rose (and yields fell) in most countries, as investors sought safer havens.

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Output, demand and jobs

Feb 6th 2003
From The Economist print edition

% change on year ago

	GDP 1 qtr*	GDP 1 year	The Economist poll GDP forecasts 2002	The Economist poll GDP forecasts 2003	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	Unemployment % rate year ago
Australia	+ 3.5	+ 3.7 Q3	+ 3.7	+ 3.2	+ 1.6 Q3	+ 5.4 Q4	6.2 Dec	6.7
Austria	+ 0.3	+ 1.2 Q3	+ 0.8	+ 1.3	+ 1.7 Nov	+ 0.6 Nov	4.2 Dec	3.9
Belgium	+ 1.8	+ 0.9 Q3	+ 0.7	+ 1.4	+ 3.1 Nov	– 0.9 Nov	11.9 Jan†	10.9
Britain	+ 1.3	+ 2.2 Q4	+ 1.7	+ 2.3	– 1.1 Nov	+ 6.4 Dec	5.2 Nov††	5.1
Canada	+ 3.1	+ 4.0 Q3	+ 3.3	+ 3.1	+ 4.9 Nov	+ 6.0 Oct	7.5 Dec	8.0
Denmark	– 2.6	+ 1.1 Q3	+ 1.6	+ 1.7	– 0.8 Nov	+ 7.5 Oct	5.4 Dec	5.1
France	+ 0.9	+ 1.0 Q3	+ 1.0	+ 1.5	+ 1.5 Oct	– 1.9 Dec	9.1 Dec	8.8
Germany	+ 1.1	+ 0.4 Q3	+ 0.2	+ 0.6	+ 2.5 Nov	– 3.2 Dec	10.3 Jan§	9.6
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.2	– 1.1 Nov	+ 1.9 Nov‡	8.9 Oct	9.3
Japan	+ 3.2	+ 1.3 Q3	– 0.3	+ 0.2	+ 6.7 Dec	– 1.8 Nov	5.5 Dec	5.5
Netherlands	+ 1.0	+ 0.3 Q3	+ 0.2	+ 0.9	+ 0.1 Nov	– 1.1 Nov	2.5 Dec**	1.8
Spain	+ 3.2	+ 1.8 Q3	+ 2.0	+ 2.3	+ 2.5 Dec	+ 4.8 Nov‡	12.0 Dec	10.7
Sweden	+ 1.6	+ 2.0 Q3	+ 1.8	+ 2.0	– 0.5 Nov	+ 4.8 Nov	4.1 Dec†	3.6
Switzerland	+ 1.3	+ 0.6 Q3	nil	+ 0.9	– 3.5 Q3	– 4.1 Nov	3.6 Dec†	2.4
United States	+ 0.7	+ 2.8 Q4	+ 2.4	+ 2.5	+ 2.1 Dec	+ 4.9 Dec	6.0 Dec	5.8
Euro area	+ 1.3	+ 0.8 Q3	+ 0.7	+ 1.3	+ 3.0 Nov	– 0.4 Nov	8.5 Dec	8.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.9	+ 2.3 Q3	na	na	+ 7.9 Dec	+ 3.8 Oct	8.1 Dec†	8.1
Greece	na	+ 3.6 Q3	na	na	+ 1.1 Nov	na	na	na
Iceland	na	+ 3.62001	na	na	+12.2 2001	na	3.1 Nov	1.6
Ireland	na	+ 6.9 Q3	na	na	+18.6 Nov	– 0.7 Nov	4.4 Dec	4.1
Luxembourg	na	+ 1.02001	na	na	– 0.7 Oct	– 2.3 Sep	3.4 Dec†	2.7
New Zealand	+ 5.0	+ 5.0 Q3	na	na	+ 5.1 Q3	+ 8.1 Q3	5.4 Q3	5.2
Norway	– 0.9	+ 1.0 Q3	na	na	– 5.1 Nov	+ 3.2 Dec	3.7 Q4	3.3
Portugal	na	– 0.5 Q3	na	na	– 1.8 Dec	– 3.5 Dec	5.1 Q3†	4.0

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Sep-Nov; claimant count rate 3.1% in Dec. §EU harmonised rate 8.6% in Jan. **Oct-Dec.

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Prices and wages

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From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.0	Q4	+ 3.1	+ 3.0	+ 2.7	+ 1.6	Q4	– 0.7	+ 3.6	Q3	+ 4.0
Austria	+ 1.8	Dec	+ 1.9	+ 1.8	+ 1.6	+ 0.8	Dec	– 1.1	+ 2.2	Dec	+ 2.7
Belgium	+ 1.2	Jan	+ 2.9	+ 1.7	+ 1.3	+ 1.4	Dec	– 2.6	+ 2.2	Q4	+ 3.1
Britain	+ 2.9	Dec	+ 0.7	+ 2.1	+ 2.6	+ 1.2	Dec	– 1.1	+ 3.8	Nov	+ 4.1
Canada	+ 3.9	Dec	+ 0.7	+ 2.2	+ 2.6	+ 2.8	Dec	– 2.4	+ 2.1	Nov	+ 3.1
Denmark	+ 2.5	Dec	+ 2.2	+ 2.4	+ 2.1	+ 1.3	Dec	+ 0.4	+ 3.9	Q3	+ 4.3
France	+ 2.3	Dec	+ 1.4	+ 1.9	+ 1.5	+ 1.7	Dec	– 1.6	+ 3.4	Q3	+ 4.2
Germany	+ 1.1	Jan	+ 2.1	+ 1.3	+ 1.0	+ 1.1	Dec	– 1.5	+ 2.3	Nov	+ 2.0
Italy	+ 2.7	Jan	+ 2.4	+ 2.6	+ 2.2	+ 1.5	Dec	– 1.3	+ 2.1	Dec	+ 2.8
Japan	– 0.3	Dec	– 1.2	– 0.9	– 0.7	+ 0.3	Nov	– 0.8	– 1.9	Dec	– 1.9
Netherlands	+ 3.2	Dec	+ 4.4	+ 3.8	+ 2.5	+ 4.0	Dec	– 2.2	+ 3.4	Dec	+ 4.9
Spain	+ 4.0	Dec	+ 2.7	+ 3.5	+ 2.9	+ 2.0	Dec	– 0.8	+ 3.8	Q3	+ 3.6
Sweden	+ 2.3	Dec	+ 2.9	+ 2.4	+ 2.1	– 0.6	Dec	– 0.8	+ 3.9	Nov	+ 3.0
Switzerland	+ 0.8	Jan	+ 0.5	+ 0.7	+ 0.7	– 0.3	Dec	– 1.9	+ 2.5	2001	+ 1.3
United States	+ 2.4	Dec	+ 1.6	+ 1.6	+ 2.1	+ 1.2	Dec	– 1.6	+ 3.0	Dec	+ 3.7
Euro area	+ 2.1	Jan	+ 2.0	+ 2.2	+ 1.7	+ 1.5	Dec	– 1.0	+ 3.3	Q3	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	Dec	+ 1.8	na	na	+ 1.4	Dec	– 2.7	+ 3.5	Q3	+ 4.7
Greece	+ 3.4	Dec	+ 3.0	na	na	+ 1.5	Dec	+ 1.5	na		na
Iceland	+ 1.4	Jan	+ 9.4	na	na	+ 2.7	Jan	+11.4	+ 5.4	Dec	+ 9.6
Ireland	+ 5.0	Dec	+ 4.2	na	na	– 0.6	Dec	+ 0.2	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.2	Dec	+ 1.7	na	na	– 0.2	Nov	– 1.0	+ 3.5	Nov	+ 4.2
New Zealand	+ 2.7	Q4	+ 1.8	na	na	– 1.7	Q3	+ 6.2	+ 2.1	Q4	+ 2.2
Norway	+ 2.8	Dec	+ 2.1	na	na	+10.1	Dec	–14.1	+ 5.0	Q3	+ 4.8
Portugal	+ 4.0	Dec	+ 3.7	na	na	+ 1.3	Dec	+ 0.6	– 0.7	Nov*	+ 4.2

*Revised series.

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Economic forecasts

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The Economist poll of forecasters, February averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2002	2003	2002	2003	2002	2003	2002	2003
Australia	3.4/3.8	2.7/3.7	3.7	3.2	3.0	2.7	–3.9	–4.2 (–4.1)
Austria	0.4/1.0	0.7/1.7	0.8 (0.7)	1.3	1.8	1.6	–0.1(–0.4)	–0.4 (–0.7)
Belgium	0.5/0.9	1.2/1.8	0.7 (0.6)	1.4	1.7	1.3	5.2 (5.0)	5.1 (5.0)
Britain	1.5/1.8	1.7/3.1	1.7 (1.6)	2.3 (2.4)	2.1 (1.9)	2.6 (2.5)	–1.6(–1.7)	–1.8
Canada	3.2/3.5	2.6/3.7	3.3	3.1	2.2	2.6 (2.5)	1.9	1.9
Denmark	1.3/1.8	1.0/2.3	1.6 (1.5)	1.7 (1.8)	2.4	2.1 (2.0)	2.2 (2.3)	2.0
France	0.9/1.1	1.1/2.0	1.0	1.5 (1.6)	1.9 (1.8)	1.5	1.7 (1.6)	1.7 (1.6)
Germany	0.2/0.3	0.3/0.9	0.2	0.6 (0.8)	1.3	1.0	2.1 (1.8)	1.8 (1.7)
Italy	0.3/0.4	0.8/1.8	0.4	1.2 (1.3)	2.6 (2.5)	2.2 (2.1)	–0.2(–0.1)	–0.2 (–0.1)
Japan	–0.7/–0.2	–0.5/1.0	–0.3	0.2 (0.4)	–0.9	–0.7	2.8	2.8
Netherlands	0.1/0.4	0.4/1.3	0.2	0.9 (1.0)	3.8	2.5	3.1 (3.6)	2.6 (3.4)
Spain	1.8/2.1	2.0/2.7	2.0	2.3	3.5	2.9 (2.8)	–2.2(–2.1)	–2.1 (–1.8)
Sweden	1.5/2.0	1.7/2.5	1.8	2.0 (2.1)	2.4	2.1 (2.0)	3.5 (3.4)	3.2
Switzerland	–0.3/0.5	0.6/1.4	nil (–0.1)	0.9 (1.0)	0.7	0.7	10.3(10.0)	10.8 (10.3)
United States	2.3/2.5	1.4/3.0	2.4	2.5	1.6	2.1 (2.0)	–4.8(–4.7)	–5.0
Euro area	0.5/0.8	0.9/1.5	0.7	1.3	2.2	1.7	0.7 (0.6)	0.8 (0.7)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, UBS Warburg

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. The panel has become gloomier about the Japanese and German economies. Japan's economy is now forecast to grow by only 0.2% this year, compared with 0.4% in January. Germany's economy is expected to grow by 0.6% in 2003, down from 0.8% a month ago. The panel has trimmed this year's growth forecast for Britain to 2.3%. Despite the stimulus to exports from a cheaper dollar, America's current-account deficit is forecast to increase from 4.8% of GDP in 2002 to 5% in 2003. The euro area's current-account surplus is expected to rise to 0.8% of GDP in 2003.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Feb 5th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 9.2	+10.6	Dec	4.78	4.28	4.50	5.12	5.86	5.86
Britain	+ 5.1	+ 6.9	Dec	3.91	4.06	3.59	4.21	4.81	5.87
Canada	+ 5.0	+ 5.1	Dec	2.84	1.97	3.57	5.14	5.39	6.85
Denmark	+ 3.8	+ 4.6	Dec	3.10	3.68	2.86	4.21	4.98	6.89
Japan	+25.2	+ 2.2	Dec	0.03	0.03	0.04	0.87	1.53	0.97
Sweden	+ 0.7	+ 2.4	Oct	3.66	3.83	3.66	4.47	5.19	4.12
Switzerland	+10.1	+ 5.6	Dec	0.60	1.67	0.51	2.27	3.37	3.16
United States	+ 3.4	+ 6.3	Dec	1.25	1.79	1.71	4.00	4.93	6.04
Euro area†	+ 9.8	+ 6.8	Dec	2.80	3.35	2.54	3.97	4.76	4.49

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.87%, Japan No.246 0.865%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 6th 2003
From The Economist print edition

1995=100

	Jan 28th	Feb 4th*	% change on one month	% change on one year
Dollar index				
All items	78.0	79.3	+ 3.8	+18.3
Food	80.6	81.4	+ 2.0	+20.4
Industrials				
All	74.4	76.4	+ 6.5	+15.5
Nfa†	76.7	79.7	+ 6.6	+25.2
Metals	72.4	73.6	+ 6.4	+ 7.9
Sterling index				
All items	75.0	75.9	+ 1.3	+ 1.9
Euro index				
All items	94.6	95.9	– 0.4	– 5.4
Yen index				
All items	98.4	101.1	+ 3.7	+ 6.0
Gold				
$ per oz	368.85	378.75	+ 8.5	+29.7
West Texas Intermediate				
$ per barrel	32.64	33.50	+ 7.5	+66.7

* Provisional. † Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	Feb 5th	2002-03 high	2002-03 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,898.3	3,440.0	2,855.5	– 1.1	–15.7	–13.7	– 0.4
Austria (ATX)	1,165.2	1,357.2	1,003.7	+ 0.4	–32.9	+ 2.2	+24.3
Belgium (Bel 20)	1,846.4	2,899.8	1,773.7	+ 2.0	–49.9	–33.6	–19.3
Britain (FTSE 100)	3,678.7	5,323.8	3,480.8	+ 5.6	–46.9	–29.5	–20.3
Canada (Toronto Composite)	6,521.0	7,958.1	5,695.3	– 0.8	–42.7	–15.2	–10.8
Denmark (KBX)	153.4	233.4	152.5	– 1.7	–49.2	–31.8	–17.0
France (SBF 250)	1,940.0	3,081.9	1,794.5	+ 1.4	–55.8	–34.9	–20.8
(CAC 40)	2,884.6	4,688.0	2,656.5	+ 1.6	–58.3	–37.6	–24.1
Germany (DAX)	2,725.9	5,462.6	2,597.9	+ 0.7	–66.2	–47.2	–35.7
Italy (BCI)	1,040.3	1,513.0	974.4	+ 2.1	–52.3	–27.4	–11.7
Japan (Nikkei 225)	8,549.9	11,979.9	8,303.4	+ 2.6	–78.0	–18.9	–11.3
(Topix)	845.3	1,139.4	760.1	+ 2.4	–70.7	–18.1	–10.4
Netherlands (AEX)	290.9	531.2	282.7	+ 2.9	–58.5	–42.6	–30.2
Spain (Madrid SE)	628.9	848.1	568.5	+ 1.2	–45.1	–23.7	– 7.2
Sweden (Affarsvarlden Gen)	139.7	236.8	122.7	+ 1.7	–65.1	–39.6	–25.8
Switzerland (Swiss Market)	4,385.0	6,694.1	4,303.5	+ 1.2	–47.9	–31.7	–16.2
United States (DJIA)	7,985.2	10,635.3	7,286.8	– 1.5	–31.9	–20.3	–20.3
(S&P 500)	843.6	1,172.5	776.8	– 2.4	–44.8	–26.5	–26.5
(NASDAQ Comp)	1,301.5	2,359.5	1,114.1	– 4.2	–74.2	–33.3	–33.3
Europe (FTSE Eurotop 300)*	800.4	1,279.7	771.1	+ 3.0	–53.1	–36.5	–22.8
Euro area (FTSE Ebloc 100)*	672.0	1,125.1	639.4	+ 1.6	–56.7	–39.6	–26.5
World (MSCI)†	765.3	1,024.4	703.7	– 0.6	–47.2	na	–23.7
World bond market (Salomon)‡	534.9	832.5	430.3	– 0.6	+ 0.7	na	+21.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 6th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† 1990=100 Feb 5th	year ago	Currency units per $ Feb 5th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	− 5.3	Dec	− 14.3	Q3	− 3.9	− 4.2	75.8	73.6	1.69	1.97	2.78	1.83	1.41	0.1
Austria	nil	Oct	− 0.6	Nov	− 0.1	− 0.4	101.3§	100.3	0.92	1.15	1.52	–	0.77	-1.6
Belgium	+ 18.0	Nov	+ 18.0	Nov	+ 5.2	+ 5.1	100.7§	99.0	0.92	1.15	1.52	–	0.77	nil
Britain	− 51.1	Nov	− 20.5	Q3	− 1.6	− 1.8	104.5	106.8	0.61	0.71	–	0.66	0.51	-1.4
Canada	+ 28.9	Nov	+ 12.4	Q3	+ 1.9	+ 1.9	77.5	75.6	1.52	1.60	2.50	1.64	1.27	0.6
Denmark	+ 7.4	Nov	+ 4.0	Nov	+ 2.2	+ 2.0	104.7	102.1	6.86	8.55	11.3	7.44	5.73	2.2
France	+ 8.1	Nov	+ 27.7	Nov	+ 1.7	+ 1.7	103.7§	101.7	0.92	1.15	1.52	–	0.77	-2.7
Germany	+118.4	Nov	+ 45.3	Nov	+ 2.1	+ 1.8	100.8§	98.6	0.92	1.15	1.52	–	0.77	-3.7
Italy	+ 10.5	Nov	− 5.0	Nov	− 0.2	− 0.2	74.0§	72.6	0.92	1.15	1.52	–	0.77	-2.3
Japan	+ 92.6	Nov	+114.8	Nov	+ 2.8	+ 2.8	129.7	127.7	120	134	197	130	–	-7.9
Netherlands	+ 28.0	Nov	+ 9.0	Q3	+ 3.1	+ 2.6	99.9§	98.0	0.92	1.15	1.52	–	0.77	-0.8
Spain	− 38.7	Nov	− 14.3	Oct	− 2.2	− 2.1	75.5§	74.3	0.92	1.15	1.52	–	0.77	nil
Sweden	+ 14.8	Dec	+ 10.8	Nov	+ 3.5	+ 3.2	78.3	75.5	8.53	10.6	14.0	9.24	7.12	1.7
Switzerland	+ 4.8	Dec	+ 29.8	Q3	+10.3	+10.8	116.5	112.0	1.35	1.69	2.23	1.47	1.13	na
United States	−467.0	Nov	−462.2	Q3	− 4.8	− 5.0	108.3	124.4	–	–	1.65	1.08	0.83	-3.1
Euro area	+ 98.3	Nov	+ 54.0	Nov	+ 0.7	+ 0.8	86.2	78.2	0.92	1.15	1.52	–	0.77	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Nov	+ 10.0	Nov	na	na	79.6§	78.5	0.92	1.15	1.51	–	0.77	3.2
Greece	− 21.1	Nov	− 8.4	Nov	na	na	58.3§	57.5	0.92	1.15	1.51	–	0.77	-1.1
Iceland	+ 0.2	Nov	nil	Q3	na	na	92.1**	83.4	77.0	102.1	127	83.4	64.2	0.3
Ireland	+ 35.2	Oct	+ 0.1	Q3	na	na	90.3§	87.4	0.92	1.15	1.51	–	0.77	-0.5
Luxembourg	− 3.0	Nov	+ 2.1	Q3	na	na	100.7§	99.0	0.92	1.15	1.51	–	0.77	1.8
New Zealand	− 0.7	Dec	− 1.7	Q3	na	na	96.2	82.4	1.82	2.40	3.00	1.97	1.52	1.6
Norway	+ 25.7	Dec	+ 26.1	Nov	na	na	105.1	97.8	6.97	9.00	11.5	7.55	5.82	12.4
Portugal	− 12.7	Oct	− 9.8	Nov	na	na	91.1**	90.2	0.92	1.15	1.51	–	0.77	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD forecast. **IMF, October average.

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Exchange rates against the dollar

Feb 6th 2003
From The Economist print edition

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Overview

Feb 6th 2003
From The Economist print edition

Consumer-price inflation edged up to 2.7% in the **Philippines** in the 12 months to January, mainly because of higher fuel prices. **Thailand's** inflation rate increased to 2.2% in the same month, up from 1.6% in December and its highest rate for 19 months. Its industrial production surged by 12% in the year to December. **Indonesia's** inflation fell to 8.7% in January.

India's exports rose by 34% in the year to December, well ahead of the 24% rise in imports. However, its overall trade deficit widened to $7.3 billion for 2002, up from $5.8 billion in 2001.

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Political and economic stability

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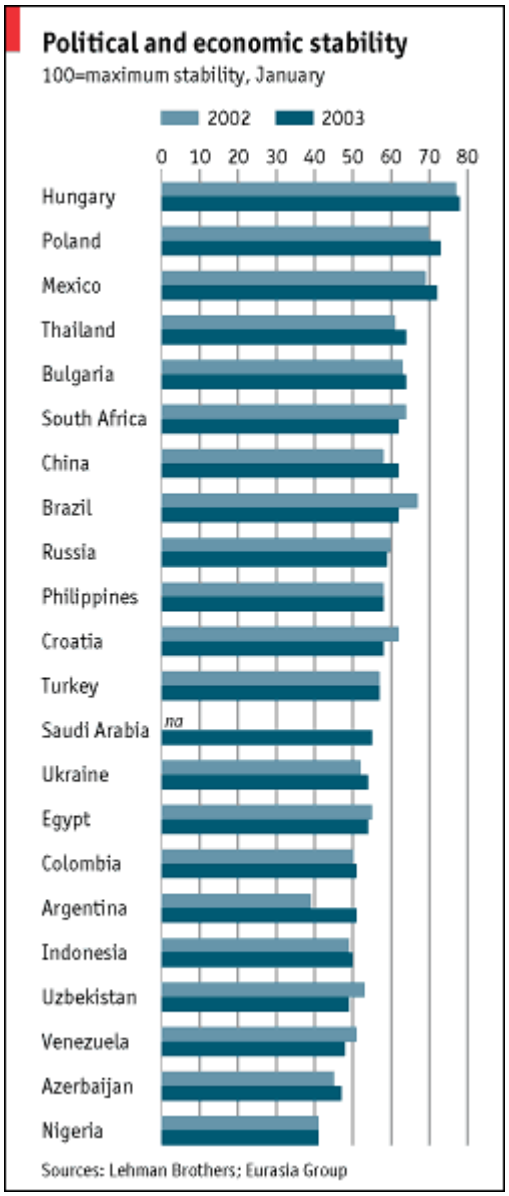
From The Economist print edition

Hungary has one of the world's most stable emerging economies, according to an index produced by Lehman Brothers and Eurasia Group, a firm that analyses political risk. The index tries to measure a country's ability to withstand crises and to avoid generating them. Argentina's perceived stability has improved substantially over the past 12 months. A year ago it scored 39 (out of a maximum of 100); now it scores 51.



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Economy

Feb 6th 2003
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.2	Q4	+14.9	Dec	– 0.4	Dec	+30.4	Dec	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 1.5	Dec	– 7.6	Dec	+16.5	Q3	111.6	Dec
India	+ 5.8	Q3	+ 3.6	Nov	+ 3.2	Dec	– 7.3	Dec	+ 4.5	Q3	67.0	Dec
Indonesia	+ 3.9	Q3	+ 1.6	Nov‡	+ 8.7	Jan	+25.4	Dec	+ 6.9	Q2	30.5	Dec
Malaysia	+ 5.6	Q3	+ 6.4	Nov	+ 1.7	Dec	+13.5	Nov	+ 6.6	Q3	34.2	Dec
Philippines	+ 5.8	Q4	– 0.7	Nov	+ 2.7	Jan	+ 1.8	Nov	+ 6.1	Sep	13.0	Dec
Singapore	+ 2.6	Q4	+19.0	Dec	+ 0.4	Dec	+ 8.7	Dec	+18.9	Q3	82.3	Dec
South Korea	+ 5.8	Q3	+ 9.5	Dec	+ 3.8	Jan	+11.3	Dec	+ 6.5	Nov	121.3	Dec
Taiwan	+ 4.8	Q3	+10.5	Dec	+ 0.8	Jan	+18.1	Dec	+25.0	Q3	161.7	Dec
Thailand	+ 6.0	Q3	+12.0	Dec	+ 2.2	Jan	+ 4.2	Dec	+ 7.6	Dec	38.1	Dec
Argentina	–10.1	Q3	– 4.6	Nov	+39.6	Jan	+16.4	Dec	+ 7.0	Q3	10.5	Dec
Brazil	+ 2.4	Q3	+ 4.5	Nov	+12.5	Dec	+13.1	Dec	– 7.8	Dec	37.8	Dec
Chile	+ 1.8	Q3	+ 7.2	Dec	+ 2.8	Dec	+ 2.4	Dec	+ 0.9	Q3	15.4	Dec
Colombia	+ 1.9	Q3	+ 5.3	Oct	+ 7.0	Dec	+ 0.1	Oct	– 1.5	Q3	10.6	Dec
Mexico	+ 1.8	Q3	– 0.5	Nov	+ 5.7	Dec	– 8.2	Dec	–16.1	Q3	50.6	Dec
Peru	+ 5.9	Nov	+ 7.4	Nov	+ 2.3	Jan	+ 0.3	Nov	– 1.0	Q3	9.1	Dec
Venezuela	– 5.5	Q3	–10.5	Oct	+31.2	Dec	+11.4	Q3	+ 4.9	Q3	9.1	Nov
Egypt	+ 3.1	2002†	+ 7.8	2001†	+ 3.1	Nov	– 8.0	Sep	+ 0.1	Q3	13.0	Oct
Israel	– 0.8	Q3	– 4.0	Nov	+ 6.5	Dec	– 6.8	Dec	– 1.9	Q3	24.0	Dec
South Africa	+ 3.1	Q3	+ 2.5	Nov	+14.4	Dec	+ 3.8	Dec	nil	Q3	5.9	Dec
Turkey	+ 7.9	Q3	+ 8.6	Nov	+26.4	Jan	–13.6	Nov	+ 0.1	Nov	26.8	Dec
Czech Republic	+ 1.5	Q3	+ 4.4	Nov	+ 0.6	Dec	– 2.4	Dec	– 4.2	Q3	23.6	Dec
Hungary	+ 3.4	Q3	+ 6.0	Nov	+ 4.8	Dec	– 3.0	Nov	– 3.3	Nov	9.8	Nov
Poland	+ 1.6	Q3	+ 5.1	Dec	+ 0.8	Dec	–10.3	Dec	– 5.7	Dec	28.7	Dec
Russia	+ 4.3	Q3	+ 3.2	Dec	+15.1	Dec	+44.2	Nov	+30.3	Q3	44.1	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	– 0.5	Jun	+ 3.3	Dec	– 1.3	Dec	+ 2.7	2002†	8.1	Dec
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+39.2	2001	+ 9.4	2001	21.4	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; UBS Warburg; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Feb 6th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 5th		Dec 31st 2001	
	Feb 5th	year ago	Feb 5th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.19	13.6	na	1,567.3**	+2.7	– 8.5	– 8.5
Hong Kong	7.80	7.80	12.8	1.44	9,180.5	–0.7	– 19.4	– 19.5
India	47.7	48.7	78.5	5.64	3,256.1	+0.6	– 0.2	+ 0.9
Indonesia	8,867	10,325	14,592	13.41	392.3	+0.2	+ 0.1	+ 17.4
Malaysia	3.80	3.80	6.25	3.10	668.2	+0.4	– 4.0	– 4.0
Philippines	54.0	51.3	88.9	7.63	1,037.3	–0.2	– 11.2	– 15.1
Singapore	1.74	1.83	2.87	0.75	1,291.9	–0.8	– 20.4	– 15.6
South Korea	1,174	1,312	1,932	4.55	600.7	+3.0	– 13.4	– 3.1
Taiwan	34.7	35.0	57.1	1.50	5,015.2§	+1.4	– 9.7	– 8.9
Thailand	42.8	43.8	70.4	1.83	373.3	+1.0	+ 22.9	+ 27.1
Argentina	3.16	2.02	5.19	5.80	562.2	+0.9	+ 90.3	– 39.7
Brazil	3.58	2.42	5.90	25.40	10,591.8	–2.5	– 22.0	– 49.7
Chile	742	689	1,221	2.64	5,010.1	+1.4	– 7.2	– 17.3
Colombia	2,959	2,255	4,870	7.65	1,620.8	–1.5	+ 51.4	+ 16.5
Mexico	10.85	9.13	17.9	8.86	5,968.5	+0.5	– 6.3	– 20.8
Peru	3.50	3.49	5.75	3.93	1,534.1	+0.3	+ 30.5	+ 28.6
Venezuela	1,922	770	3,163	31.08	8,451.7	–2.7	+ 28.6	– 49.3
Egypt	5.52	4.63	9.08	6.31	6,231.3	+8.3	+ 18.2	– 2.0
Israel	4.87	4.63	8.02	6.03	309.3	–3.5	– 30.8	– 37.3
South Africa	8.4	11.5	13.9	13.60	8,869.2	–0.9	– 15.1	+ 21.0
Turkey	1,645,500	1,328,000	2,707,999	42.00	10,659.9	–0.6	– 22.7	– 31.6
Czech Republic	29.3	36.7	48.2	2.54	475.4	+2.1	+ 20.5	+ 46.2
Hungary	226	281	372	5.96	7,432.7	–0.7	+ 4.2	+ 26.7
Poland	3.84	4.23	6.32	6.47	13,878.0	–0.3	– 0.3	+ 2.6
Russia	31.8	30.8	52.4	21.00	346.8	+0.1	+ 39.2	+ 33.4
EMF (MSCI)*	1.00	1.00	1.65	na	291.5	+0.8	na	– 8.2
EMBI+†	1.00	1.00	1.65	na	233.2	+0.6	na	+ 16.4

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. §Jan 28th.**Jan 29th

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; UBS Warburg; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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